

STATE EMPLOYEES' RETIREMENT SYSTEM OF ILLINOIS

A PENSION TRUST FUND OF THE STATE OF ILLINOIS

COMPREHENSIVE ANNUAL FINANCIAL REPORT

FOR THE FISCAL YEAR ENDED
JUNE 30, 1997

STATE EMPLOYEES'
RETIREMENT SYSTEM
OF ILLINOIS

2101 South Veterans Parkway
P.O. Box 19255
Springfield, Illinois 62794 - 9255

Prepared by the
Accounting Division

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INTRODUCTORY SECTION

- Letter of Transmittal
- Administration, Board of Trustees and Administrative Staff
- Certificate of Achievement for Excellence in Financial Reporting



- State Employees' Retirement System of Illinois
- General Assembly Retirement System
- Judges' Retirement System of Illinois

2101 South Veterans Parkway, P.O. Box 19255, Springfield, IL 62794-9255, Ph. (217)785-7444

December 1, 1997

The Board of Trustees and Members
State Employees' Retirement System of Illinois
Springfield, IL 62794

Dear Board and Members:

The comprehensive annual financial report of the State Employees' Retirement System of Illinois (System) as of and for the fiscal year ended June 30, 1997 is hereby submitted. Responsibility for both the accuracy of the data and the completeness and fairness of the presentation, including all disclosures, rests with the System. To the best of our knowledge and belief, the enclosed data are accurate in all material respects and are reported in a manner designed to present fairly the financial position and results of operations of the various funds of the System. All disclosures necessary to enable the reader to gain an understanding of the System's financial activities have been included. The report consists of six sections:

1. An Introductory Section which contains this letter of transmittal and the identification of the administrative organization and the Certificate of Achievement for Excellence in Financial Reporting;
2. The Financial Section which contains the report of the Independent Auditors, the financial statements of the System, and certain required and other supplementary financial information;
3. The Actuarial Section which contains an Actuary's Certification Letter and the results of the annual actuarial valuation;
4. The Investment Section which contains a summary of the System's investment management approach and selected summary tables, including investment performance;
5. The Statistical Section which contains significant statistical data; and
6. A summary of the System's plan provisions and current legislative changes.

Generally accepted accounting principles require that the financial reporting entity include: (1) the primary government; (2) organizations for which the primary government is financially accountable; and (3) other organizations for which the nature and significance of their relationship with the primary government are such that exclusion would cause the reporting entity's financial statements to be misleading or incomplete. Based on the criteria of the Governmental Accounting Standards Board Statement No. 14, there are no other state agencies, boards or commissions, or other organizations required to be combined with the System, however, the System is considered to be part of the State of Illinois financial reporting entity, and is to be combined and included in the State of Illinois' comprehensive annual financial report. Although the State Employees' Retirement System, Judges' Retirement System and General Assembly Retirement System share a common administration, they are separate entities for legal and financial reporting purposes. Therefore, the financial statements of the State Employees' Retirement System do not include plan net asset information nor the changes in plan net assets of the General Assembly Retirement System or Judges' Retirement System.

PLAN HISTORY AND SERVICES PROVIDED

The System is the administrator of a single-employer public employee retirement system established to provide pension benefits for State of Illinois employees. The System also administers widows and survivors benefits as well as the state's occupational and non-occupational disability programs.

The System was established January 1, 1944 and 17,237 state employees became members on that date. As of June 30, 1944, net assets of the System amounted to \$1,255,778. The fair value of plan net assets at the end of the fiscal year June 30, 1997 are approximately \$6.0 billion, and there are 79,697 active members.

ADDITIONS TO PLAN NET ASSETS

The collection of employer and employee retirement contributions, as well as income from investments, provide the reserves necessary to finance retirement benefits. These revenue sources totaled \$1,256.5 million during the fiscal year ending June 30, 1997, which is a significant increase from revenue reported for fiscal year 1996, shown as follows:

	1997 (Millions)	1996 (Millions)	Increase / (Decrease) (Millions) (Percentage)	
Contributions:				
Employees	\$ 145.7	\$ 137.2	\$ 8.5	6.2%
Employer	158.2	146.4	11.8	8.1
Investments	952.6	736.2	216.4	29.4
	<u>\$1,256.5</u>	<u>\$1,019.8</u>	<u>\$236.7</u>	<u>23.2%</u>

As indicated in the above schedule, approximately 91% of the total revenue increase was attributable to an increase in investment income which was largely the result of significant net appreciation in the fair value of investments.

DEDUCTIONS FROM PLAN NET ASSETS

The primary expense of a retirement system relates to the purpose for which it is created; namely the payment of benefits. These payments, together with the expense to administer the plan, constitute the total expenses of the System. Expenses of the System for 1997 and 1996 are shown for comparison purposes.

	1997 (Millions)	1996 (Millions)	Increase / (Decrease) (Millions) (Percentage)	
Benefits:				
Retirement annuities	\$ 298.4	\$ 286.2	\$ 12.2	4.3%
Survivors' annuities	35.2	33.0	2.2	6.7
Disability benefits	23.8	22.4	1.4	6.3
Lump-sum death benefits	11.3	10.8	.5	4.6
	<u>\$ 368.7</u>	<u>\$ 352.4</u>	<u>\$ 16.3</u>	<u>4.6%</u>
Refunds (including Transfers)	12.7	13.4	(.7)	(5.2)
Administrative expenses	5.7	5.7	-	-
	<u>\$ 387.1</u>	<u>\$ 371.5</u>	<u>\$ 15.6</u>	<u>4.2%</u>

The increase in benefit payments results primarily from an increase in the average benefit payment amount.

INVESTMENTS

The System's investments are managed by the Illinois State Board of Investment (ISBI) pursuant to Chapter 40, Article 5/22A of the Illinois Compiled Statutes, using the "prudent person rule". This rule states that fiduciaries shall discharge their duties solely in the interest of the fund participants and beneficiaries and with the degree of diligence, care and skill which prudent men and women would ordinarily exercise under similar circumstances in a like position. The ISBI maintains a wide diversification of investments within this fund which serves to reduce overall risk and increase returns.

Income from investments has, over the years, increasingly become a greater share of the total revenue of the System. Net investment income, combined with the net appreciation of fair value of investments, amounted to \$952.6 million during fiscal year 1997, an increase of \$216.4 million from fiscal year 1996. Income from investments represents 75.8% of total fund revenue. The Illinois State Board of Investment had an 18.8% rate of return on market values for the year ended June 30, 1997.

A detailed discussion of investment performance and strategies is provided in the Investment Section. Information regarding investment professionals providing services to the ISBI can be found in the separately issued ISBI report. To receive a copy of the ISBI annual financial report, please refer to the address contained in the Investment Section.

FUNDING

Funding is the process of specifically allocating monies for current and future use. Proper funding includes an actuarial review of the fund balances to ensure that funds will be available for current and future benefit payments. The greater the level of funding, the larger the ratio of accumulated assets to the actuarial accrued liability and the greater the level of investment potential.

Senate Bill 533, which was signed into law by Governor Edgar on August 22, 1994, as Public Act 88-0593, enacted a new funding plan for the System. The financing objective of this funding plan requires that state contributions be paid to the System so that by the end of fiscal year 2045, the ratio of accumulated assets to the actuarial accrued liability will be 90%. For fiscal years 2011 through 2045, the required state contributions are to be computed as a level percentage of participant payroll. For those fiscal years up through 2010, the required state contributions are to be increased incrementally as a percentage of the participant payroll so that by fiscal year 2011 the state is contributing at the required level contribution rate to achieve the financing objective by the end of fiscal year 2045. In addition, the funding legislation also provided for the establishment of a continuing appropriation of the required state contributions to the System. This will, in effect, remove the appropriation of these funds from the annual budgetary process.

The actuarial determined liability of the System using the projected unit credit actuarial method at June 30, 1997, amounted to \$7.548 billion. The actuarial value of assets (at fair value) amounted to \$6.048 billion as of the same date.

A detailed discussion of funding is provided in the Actuarial Section of this report.

MAJOR EVENTS/INITIATIVES

During the past fiscal year, the System has continued its efforts to: enhance the annual member benefit statement; comply with federal mandates; upgrade the documentation of various computer systems; and convert to a new governmental accounting pension reporting standard.

Projects for Fiscal Year 1998 will primarily involve an agency wide effort to implement a new benefit package signed into law by Governor Jim Edgar on July 15, 1997. This new pension legislation will

increase the basic retirement benefits earned by over 62,000 state employees. In addition, several other bills were signed by the Governor and will take effect on or after July 1, 1997. A general description of all recent legislation is contained in the Plan Summary and Legislative Section of this annual report.

ACCOUNTING SYSTEM AND INTERNAL CONTROL

This report has been prepared to conform with the principles of governmental accounting and reporting pronounced by the Governmental Accounting Standards Board and the American Institute of Certified Public Accountants. The accrual basis of accounting is used to record the financial transactions and activities of the System. Revenues are recognized in the accounting period in which they are earned, without regard to the date of collection, and expenses are recognized when the corresponding liabilities are incurred, regardless of when payment is made. Effective July 1, 1996 the System adopted and has implemented in these financial statements Governmental Accounting Standards Board (GASB) Statement No. 25, Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans. The System also uses the State of Illinois, Comptroller's Uniform Statewide Accounting System (CUSAS) as a basis for the preparation of the financial statements. In developing the System's accounting system, consideration is given to the adequacy of internal accounting controls. These controls are designed to provide reasonable assurance regarding the safekeeping of assets and the reliability of financial records. Constant effort is directed by the System at improving this level to assure the participants of a financially sound retirement system.

PROFESSIONAL SERVICES

Independent consultants are retained by the Board of Trustees to perform professional services that are essential to the effective and efficient operation of the System. Actuarial services are provided by Watson Wyatt Worldwide, Chicago, Illinois. Tax consulting services are provided by the accounting firm of KPMG Peat Marwick, Chicago, Illinois. The annual financial audit of the System was conducted by the accounting firm of McGladrey & Pullen, LLP, under the direction of the Auditor General of the State of Illinois. In addition to the annual financial audit, a one year compliance audit was also performed by the auditors. The purpose of the compliance audit was to determine whether the System obligated, expended, received and used public funds of the state in accordance with the purpose for which such funds have been authorized by law. The System's investment function is managed by the Illinois State Board of Investment.

CERTIFICATE OF ACHIEVEMENT

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the State Employees' Retirement System of Illinois for its comprehensive annual financial report for the fiscal year ended June 30, 1996. The Certificate of Achievement is a prestigious national award recognizing excellence in the preparation of state and local government financial reports.

To be awarded a Certificate of Achievement, a governmental unit must publish an easily readable and efficiently organized CAFR, whose contents meet or exceed program standards. This report must satisfy both generally accepted accounting principles and applicable legal requirements.

A Certificate of Achievement is valid for a period of one year only. The State Employees' Retirement System of Illinois has received a Certificate of Achievement for the past eleven consecutive years (fiscal years ended June 30, 1986 through June 30, 1996). We believe our current report continues to conform to the Certificate of Achievement program requirements, and we are submitting it to the GFOA to determine its eligibility for another certificate.

ACKNOWLEDGMENTS AND COMMENTS

The preparation of this report reflects the combined efforts of the System's staff under the direction of the Board of Trustees. It is intended to provide complete and reliable information as a basis for making management decisions, as a means of determining compliance with legal provisions, and as a means for determining responsible stewardship for the assets contributed by the members in the State of Illinois. On behalf of the Board of Trustees, we would like to express our appreciation to the staff and professional consultants who worked so effectively to ensure the successful operation of the System.

On a sad note, Mr. Edward L. Stewart, a SERS Board member for approximately six years, passed away. While on the Board, Mr. Stewart primarily represented the interests of the System's annuitants. He also had a long and distinguished career as a state employee and will be remembered for his dedication to the Board and devotion to the System's membership.

Respectfully submitted,


Michael L. Mory
Executive Secretary


Nicholas C. Merrill, Jr., CPA
Chief Fiscal Officer

Board of Trustees



Loren Iglarsh
Representing Loleta A. Didrickson
Comptroller



Kenneth W. Obrecht
Chairman, appointed
by the Governor



Sharon Ward
Representing Joan Walters
Director of the Bureau of the Budget



Edward L. Stewart
(Deceased)
Annuitant, Appointed
by the Governor



Doris Clark
Elected Annuitant



Caryl Wadley-Foy
Elected Employee

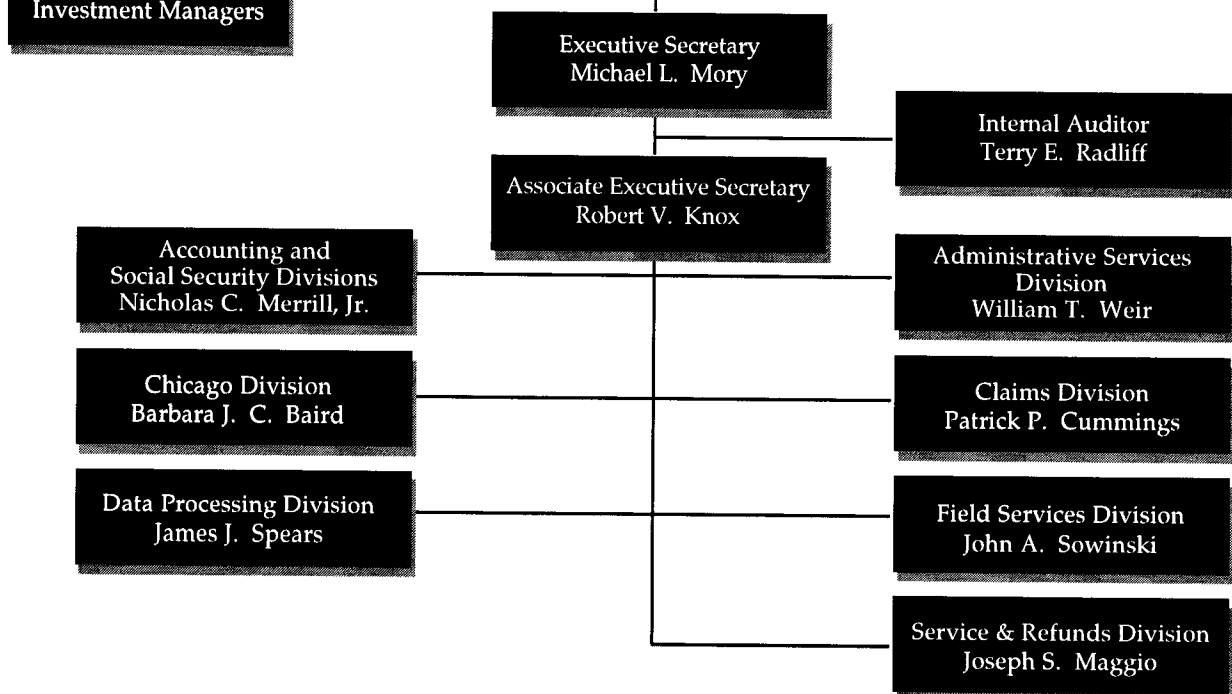


William T. Margalus
State Employee, Appointed
by the Governor

Consultants



Staff



Certificate of Achievement for Excellence in Financial Reporting

Presented to

State Employees' Retirement System of Illinois

For its Comprehensive Annual
Financial Report
for the Fiscal Year Ended
June 30, 1996

A Certificate of Achievement for Excellence in Financial Reporting is presented by the Government Finance Officers Association of the United States and Canada to government units and public employee retirement systems whose comprehensive annual financial reports (CAFRs) achieve the highest standards in government accounting and financial reporting.



Linda K. Savitsky
President

Jeffrey L. Esser
Executive Director

FINANCIAL SECTION

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 - Summary Schedule of Cash Receipts and Disbursements



McGLADREY & PULLEN, LLP

Certified Public Accountants and Consultants

INDEPENDENT AUDITOR'S REPORT

To the Honorable William G. Holland
Auditor General, State of Illinois
Springfield, Illinois

Board of Trustees
State Employees' Retirement System of Illinois
Springfield, Illinois

As Special Assistant Auditors for the Auditor General, State of Illinois, we have audited the accompanying financial statements, as listed in the table of contents, of the State Employees' Retirement System of Illinois as of and for the years ended June 30, 1997 and 1996. These financial statements are the responsibility of the System's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the State Employees' Retirement System of Illinois as of June 30, 1997 and 1996, and the results of its operations for the years then ended in conformity with generally accepted accounting principles.

As discussed in Note 10, the System adopted the provisions of Governmental Accounting Standards Board Statement No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 24, 1997 on our consideration of the State Employees' Retirement System of Illinois' internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants.

Our audits were made for the purpose of forming an opinion on the basic financial statements as of and for the years ended June 30, 1997 and 1996, taken as a whole. The schedules of funding progress and employer contributions are not a required part of the financial statements but are supplementary information required by the Governmental Accounting Standards Board. The summary of revenues by source and summary schedule of cash receipts and disbursements are not a required part of the financial statements but are supplementary financial information presented for additional analysis. Such information has been subjected to the auditing procedures applied in the audits of the basic financial statements and, in our opinion, is fairly presented in all material respects in relation to the financial statements taken as a whole.

McGladrey & Pullen, LLP

Springfield, Illinois
October 24, 1997

STATE EMPLOYEES' RETIREMENT SYSTEM OF ILLINOIS

Statements of Plan Net Assets - June 30, 1997 and 1996

Assets	1997	1996
Cash	\$ 69,478,145	\$ 51,602,122
Receivables:		
Contributions:		
Participants	6,383,074	5,650,761
Employing state agencies	5,985,073	5,821,391
Other accounts	2,055,130	1,743,249
	<u>\$ 14,423,277</u>	<u>\$ 13,215,401</u>
Investments - held in the Illinois State Board of Investment Commingled Fund at fair value	5,965,539,268	5,115,275,081
Property and equipment, net of accumulated depreciation	3,771,484	3,811,862
Total Assets	<u>\$ 6,053,212,174</u>	<u>\$ 5,183,904,466</u>
Liabilities		
Benefits payable	\$ 1,912,934	\$ 2,183,748
Refunds payable	212,554	116,463
Administrative expenses payable	1,235,638	1,141,269
Participants' deferred service credit accounts	1,823,823	1,782,629
Total Liabilities	<u>\$ 5,184,949</u>	<u>\$ 5,224,109</u>
Net assets held in trust for pension benefits	<u>\$ 6,048,027,225</u>	<u>\$ 5,178,680,357</u>

(A Schedule of Funding Progress for the Plan is presented on page 24.)

See accompanying notes to financial statements.

STATE EMPLOYEES' RETIREMENT SYSTEM OF ILLINOIS

Statements of Changes in Plan Net Assets

Years ended June 30, 1997 and 1996

	1997	1996
Additions:		
Contributions:		
Participants	\$ 145,683,543	\$ 137,220,037
Employing State agencies and appropriations	158,179,514	146,397,934
Total Contributions revenue	303,863,057	283,617,971
Investment income:		
Net investments income	213,670,347	193,491,522
Interest earned on cash balances	3,346,821	2,265,444
Net appreciation in fair value of investments	735,593,840	540,406,296
Total net investments revenue	952,611,008	736,163,262
Total additions	1,256,474,065	1,019,781,233
Deductions:		
Benefits:		
Retirement annuities	298,359,093	286,277,462
Survivors' annuities	35,239,862	32,972,599
Disability benefits	23,813,616	22,435,912
Lump-sum death benefits	11,256,372	10,792,160
Total Benefits	368,668,943	352,478,133
Refunds	12,635,835	13,378,007
Administrative	5,735,827	5,654,407
Transfers to reciprocating retirement systems	86,592	4,151
Total Deductions	387,127,197	371,514,698
Net increase	\$ 869,346,868	\$ 648,266,535
Net assets held in trust for pension benefits:		
Beginning of year	5,178,680,357	4,530,413,822
End of year	\$ 6,048,027,225	\$ 5,178,680,357

See accompanying notes to financial statements.

STATE EMPLOYEES' RETIREMENT SYSTEM OF ILLINOIS

Notes to Financial Statements June 30, 1997 and 1996

(1) Reporting Entity

Generally accepted accounting principles require that the financial reporting entity include: (1) the primary government; (2) organizations for which the primary government is financially accountable; and (3) other organizations for which the nature and significance of their relationship with the primary government are such that exclusion would cause the reporting entity's financial statement to be misleading or incomplete.

The State Employees' Retirement System (System) of Illinois is administered by a Board of Trustees consisting of seven persons, which includes: a) the Director of the Bureau of the Budget; b) the Comptroller; c) one trustee, not a state employee, who shall be chairman, to be appointed by the Governor for a 5 year term; d) two members of the system, one of whom shall be an annuitant age 60 or over, having at least 8 years of creditable service, to be appointed by the Governor for terms of 5 years; e) one member of the System having at least 8 years of creditable service, to be elected from the contributing membership of the System by the contributing members; and f) one annuitant of the System who has been an annuitant for at least one full year, to be elected from and by the annuitants of the System.

Based on the criteria of the Governmental Accounting Standards Board Statement No. 14, there are no other state agencies, boards or commissions, or other organizations required to be combined with the System, however, the System is considered to be part of the State of Illinois financial reporting entity, and is to be combined and included in the State of Illinois' comprehensive annual financial report. Pursuant to federal tax laws and regulations governing the administration of public employee pension plans, the System has established a separate fund for the sole purpose of disbursing benefits in accordance with Section 415 of the Internal Revenue Code. The total receipts and disbursements of the fund for Fiscal Year 1997 both amounted to approximately \$4,000. Due to the immaterial nature of the separate fund, these receipts and disbursements have been included in the financial statements of the System.

(2) Plan Description

The System is the administrator of a single-employer, defined benefit public employee retirement system (PERS) established and administered by the State of Illinois to provide pension benefits for its employees.

At June 30, 1997 and 1996, the number of participating state agencies, boards and commissions totaled:

	1997	1996
State agencies	40	40
State boards and commissions	48	48
Total	88	88

At June 30, 1997 and 1996 the System Trust Fund membership consisted of:

Retirees and beneficiaries currently receiving benefits:		
Retirement annuities	27,690	27,900
Survivors' annuities	9,565	9,462
Disability benefits	1,976	1,870
	39,231	39,232
Inactive employees entitled to benefits but not yet receiving them	3,291	3,138
Total	42,522	42,370

Current Employees:

Vested:	Coordinated with Social Security	48,243	45,679
	Noncoordinated	4,757	4,976
Nonvested:	Coordinated with Social Security	25,945	27,971
	Noncoordinated	752	586
Total		79,697	79,212

Operation of the System and the direction of its policies are the responsibility of the Board of Trustees of the System.

(a) Eligibility and Membership

Membership is automatic for most state employees who are not eligible for another state-sponsored retirement plan. Generally, all persons entering state service, except those in positions subject to membership in other state sponsored retirement systems, persons employed after June 30, 1979 as public service employment program participants under the Federal CETA program, and enrollees in the Illinois Young Adult Conservation Corps, become members of the System upon completion of six months service. Employees appointed by the Governor and requiring confirmation by the State of Illinois Senate may elect to become members of the System.

(b) Contributions

Participating members contribute specified percentages of their salaries for retirement annuities and survivors' annuities in accordance with Chapter 40, Section 5/14-133 of the Illinois Compiled Statutes (ILCS). Contributions are excluded from gross income for Federal and State income tax purposes. The total contribution rate is 4% if the member is coordinated with Social Security and 8% if the member is not coordinated. Certain employment categories which are eligible for benefits under alternative formulas contribute at the rate of 5 1/2% or 9 1/2 % depending upon whether or not the employee is coordinated with Social Security. Participants' contributions are fully refundable, without interest, upon withdrawal from state employment. Effective January 1, 1992, the State of Illinois initiated an employer pickup of employee retirement contributions for most state employees. The amount of the pickup is dependent upon the contribution rates specified above, however, the contributions made on behalf of the member are included in the individual member's account. The State of Illinois is obligated to make payment for the required departmental employer contributions, all allowances, annuities, any benefits granted under Chapter 40, Article 5/14 of the ILCS and all administrative expenses of the System to the extent specified in the ILCS. State law provides that the employer contribution rate be determined based upon the results of each annual actuarial valuation.

(c) Benefits

The System is governed by Chapter 40, Article 5/14 of the ILCS. Vesting and benefit provisions of the System are defined in the ILCS. Employees who retire at or after age 60 with 8 years of credited service (or at age 55 with at least 30 years of credited service with reduced benefits) are entitled to an annual retirement benefit, payable monthly for life, in an amount based upon final average compensation and credited service. Employees with 35 years of credited service may retire at any age with full benefits. Final average compensation for retirement and survivors' annuities, is the employee's average salary, during a 48 consecutive month period within the last 120 months of service in which the total compensation was the highest. State policemen use their final rate of pay for the final average compensation.

Occupational and nonoccupational (including temporary) disability benefits are available through the System. To be eligible for nonoccupational (including temporary) disability benefits, an employee must have at least eighteen months of credited service with the System. The nonoccupational (including temporary) disability benefit is equal to 50% of the monthly rate of compensation of the employee on the date of removal from the payroll. Occupational disability benefits are provided when the member becomes disabled as a direct result of injuries or diseases arising out of and in the course of state employment. The monthly benefit is equal to 75% of the monthly rate of compensation on the date of removal from the payroll. This benefit amount is reduced by Workers' Compensation or payments under the Occupational Diseases Act.

Occupational and nonoccupational death benefits are also available through the System. Certain nonoccupational death benefits vest after eighteen months of credited service. Occupational death benefits are provided from the date of employment.

(3) Summary of Significant Accounting Policies and Plan Asset Matters

(a) Basis of Accounting

The financial transactions of the System are maintained and these financial statements have been prepared using the accrual basis of accounting in conformity with generally accepted accounting principles. Employee and employer contributions are recognized as revenues in the period in which employee services are performed. The System has elected to apply only applicable FASB Statements and Interpretations issued on or before November 30, 1989, that do not contradict GASB Pronouncements.

(b) Cash and Investments

The System retains all of its available cash in a commingled investment pool managed by the Treasurer of the State of Illinois (Treasurer). All deposits are fully collateralized by the Treasurer. "Available cash" is determined to be that amount which is required for the current operating expenditures of the System. The excess of available cash is transferred to the Illinois State Board of Investment (ISBI) for purposes of long-term investment for the System.

The System transfers money to the ISBI for investment in the ISBI Commingled Fund. This money is then allocated among various investment managers to pursue a specific investment strategy. All investment transactions are initiated by the investment managers (either internal or external). The transaction settlement information is then forwarded to the agent bank's trust department under a master custodial agreement. Custody of a majority of the actual physical securities is maintained at an agent of the agent bank's trust department using a book-entry system. The ISBI's master custodian is The Northern Trust Company. The agent of the master custodian is the Depository Trust Company.

Investments are managed by the ISBI pursuant to Chapter 40, Article 5/22A of the Illinois Compiled Statutes (ILCS) and are maintained in the ISBI Commingled Fund. The ISBI reports securities at fair value. Where appropriate, the fair value includes estimated disposition costs. Fair value for stocks is determined by using the closing price listed on the national securities exchanges as of June 30. Market value for fixed income securities are determined principally by using quoted market prices provided by independent pricing services. For commingled equity funds the net asset value is determined and certified by the commingled equity fund manager as of June 30. Fair value for directly owned real estate investments is determined by appraisals. Units of the ISBI Commingled Fund are issued to the member systems on the last day of the month based on the unit net asset value calculated as of that date. Net investment income of the ISBI Commingled Fund is allocated to each of the member systems on the last day of the month on the basis of percentage of accumulated units owned by the respective systems. Management expenses are deducted monthly from income before distribution.

The investment authority of the ISBI is provided in Chapter 40, Section 5/22A-112 of the ILCS. The ISBI investment authority includes investments in obligations of the U.S. Treasury and other agencies, notes secured by mortgages which are insured by the Federal Housing Commission, real estate, common and preferred stocks, convertible debt securities, deposits or certificates of deposit of federally insured institutions and options. Such investment authority requires that all opportunities be undertaken with care, skill, prudence and diligence given prevailing circumstances that a prudent person acting in like capacity and experience would undertake. The ISBI does not have any one investment which represents 5 percent or more of the ISBI's net assets.

The ISBI participates in a securities lending program at its custodian bank, whereby securities are loaned to brokers and, in return, the ISBI has rights to a portion of a collateral pool. All of the ISBI's securities are eligible for the securities lending program. Collateral consists solely of cash, letters of credit, commercial paper and government securities having a market value equal to or greater than the securities loaned. There are no provisions for ISBI indemnification on the securities lending transactions. As of June 30, 1997 and 1996, the ISBI had outstanding loaned investment securities having market values of \$1,159,430,394 and \$959,943,956 respectively; against which it had received collateral with values of \$1,191,334,581 and \$994,346,404, respectively.

The ISBI's global and international managers invest in derivative securities. During the year, the ISBI's derivative investments included forward foreign currency contracts, futures, and options. Forward foreign currency contracts are used to hedge against the currency risk in the ISBI's foreign stock and fixed income portfolios. The remaining derivative securities are used to improve yields, or to hedge changes in interest rates.

The ISBI also invests in mortgage-backed securities to maximize yields and to hedge against a rise in interest rates. These securities are based on cash flows from principal and interest payments on underlying mortgages. Therefore, they are sensitive to prepayments by mortgagees, which may result from a decline in interest rates.

For additional information regarding the ISBI's investments, please refer to the Annual Report of the ISBI dated June 30, 1997. A copy of the report can be obtained from the ISBI at 180 North LaSalle Street, Suite 2015, Chicago, Illinois 60601.

The System owns approximately 94% of the net investment assets of the ISBI Commingled Fund as of June 30, 1997.

ISBI investments, as categorized by ISBI, are categorized to indicate the level of risk assumed by the ISBI at year end. Category I includes investments that are insured or registered or the securities are held by the master custodian in the ISBI's name. Category II includes uninsured and unregistered investments with the securities held by the counterparty's agent in the ISBI's name. Category III includes uninsured and unregistered investments with the securities held by the counterparty but not in the ISBI's name. Investments in pooled funds are not categorized because they are not evidenced by securities that exist in physical or book entry form.

At June 30, 1997, the ISBI's investments were categorized as follows:

	Market Value	Category I	Non Categorized
U.S. Government & Agency Obligations	\$ 1,137,289,413	\$ 1,137,289,413	\$
Foreign Obligations	38,894,843	38,894,843	
Corporate Obligations	648,401,848	608,628,917	39,772,931
Convertible Bonds	7,708,471	7,708,471	
Common Stock & Equity Funds	2,424,361,786	1,528,269,876	896,091,910
Convertible Preferred Stock	21,207,595	21,207,595	
Preferred Stock	25,335,680	25,335,680	
Foreign Equity Securities	1,019,434,063	862,350,182	157,083,881
Real Estate Funds	252,606,430		252,606,430
Alternative Investments	306,053,788		306,053,788
Money Market Instruments	419,376,908	144,766,082	274,610,826
Forward Foreign Exchange Contracts	1,008,282	1,008,282	
Options	4,465,309	4,465,309	
Total Investments	\$ 6,306,144,416	\$ 4,379,924,650	\$ 1,926,219,766

(c) Actuarial Experience Review

In accordance with Illinois Compiled Statutes, an actuarial experience review is to be performed at least once every five years to determine the adequacy of actuarial assumptions regarding the mortality, retirement, disability, employment, turnover, interest and earnable compensation of the members and beneficiaries of the System. The System's actuarial consultant performed an experience review for the period ended June 30, 1997.

Based upon the results of the review, several changes were made to the actuarial assumptions. These changes had the effect of decreasing the actuarial liability and the related unfunded actuarial liability by \$380 million and were primarily the results of adjustments to expected salary increases and investment returns.

(d) Administrative Expenses

Expenses related to the administration of the System are budgeted and approved by the System's Board of Trustees.

(e) Risk Management

The System, as part of the primary government of the State, provides for risks of loss associated with workers' compensation and general liability through the State's self-insurance program. The System obtains commercial insurance for fidelity and surety and property. There have been no commercial insurance claims in the past three fiscal years.

(4) Funding - Statutory Contributions Required and Contributions Made

On an annual basis, a valuation of the liabilities and reserves of the System is performed by the System's actuarial consultants in order to determine the amount of contributions statutorily required from the State of Illinois. For fiscal years 1997 and 1996, the actuary has used the projected unit credit actuarial method for determining the proper employer contribution rate and amount. The Board certified actuarial required payroll contribution rates for fiscal years 1997 and 1996, were 4.963% and 4.767%, respectively. The total actuarial required contribution rates (i.e. including payroll and non-payroll employer contributions) for fiscal years 1997 and 1996 were 5.284% and 5.097%, respectively.

The Illinois General Assembly subsequently appropriated the employer's payroll contribution for these same percentages as well as a specific dollar amount for the non-payroll contributions. For fiscal years 1997 and 1996, the required employer payroll contributions were computed in accordance with Public Act 88-0593. This funding legislation, which became effective July 1, 1995, provides for a systematic 50 year funding plan with an ultimate goal to fund the cost of maintaining and administering the System at an actuarial funded ratio of 90%. In addition, the new funding plan provides for a 15 year phase-in period to allow the state to adapt to the increased financial commitment. Once the 15 year phase-in period is complete, the state's contribution will then remain at a level percentage of payroll for the next 35 years until the 90% funded level is achieved.

(5) Administrative Expenses and Other Postemployment Benefits

A summary of the administrative expenses of the System for fiscal years 1997 and 1996 are as follows:

	1997	1996
Personal services	\$ 2,500,263	\$ 2,367,892
Employer retirement pickup	99,822	94,297
Retirement contributions	124,428	113,145
Social Security contributions	181,546	171,694
Group insurance	288,599	276,666
Contractual services	1,140,265	1,140,711
Travel	55,967	51,926
Commodities	25,888	24,131
Printing	48,108	51,678
Electronic data processing	926,867	830,463
Telecommunications	65,449	67,974
Automotive	10,307	10,118
Depreciation	220,751	386,461
Other	47,567	67,251
Total	\$ 5,735,827	\$ 5,654,407

Effective January 1, 1992, the System began making payment of the required employee retirement contributions on behalf of its employees. This "pickup" of employee retirement contributions was included in the fiscal year 1992 operating budget approved by the System's Board of Trustees, and was, in part, paid in lieu of a salary increase.

In addition to providing pension benefits, the State Employees Group Insurance Act of 1971, as amended, requires that certain health, dental and life insurance benefits shall be provided by the state to annuitants who are former state employees. This includes annuitants of the System. Substantially all state employees including the System's employees may become eligible for post-employment benefits if they eventually become annuitants. Health and dental benefits include basic benefits for annuitants under the state's self-insurance plan and insurance contracts currently in force. Life insurance benefits are limited to five thousand dollars per annuitant age 60 and older.

Costs incurred for health, dental and life insurance for annuitants and their dependents were not separated from benefits provided to active employees and their dependents for the year ended June 30, 1997. However, post-employment costs for the State as a whole for all State agencies/ departments for health, dental and life insurance for annuitants and their dependents are disclosed in the State of Illinois Comprehensive Annual Financial Report. Cost information for retirees by individual State agency is not available. Payments are made on a "pay-as-you-go" basis. The System is not the administrator of any of the other post-employment benefits described above.

(6) Property and Equipment

Fixed assets are capitalized at their cost at the time of acquisition. Depreciation is computed using the straight-line method over the estimated useful life of the asset. The estimated useful lives are as follows: (1) office furniture - 10 years, (2) equipment - 6 years, (3) automobiles and certain electronic data processing equipment - 3 years, and (4) building - 30 years. Land is carried at its original cost, including applicable legal fees, surveying costs, etc.

A summary of the changes in fixed assets for 1997 and 1996 is as follows:

	Beginning Balance	1997		Ending Balance
		Additions	Deletions	
Land	\$ 655,241	\$ -	\$ -	\$ 655,241
Land Improvements	208,693	-	-	208,693
Building	3,213,533	71,047	-	3,284,580
Equipment	1,857,132	109,417	(2,436)	1,964,113
Total	5,934,599	180,464	(2,436)	6,112,627
Accumulated Depreciation	(2,122,737)	(220,752)	2,346	(2,341,143)
Property and equipment, net	<u>\$ 3,811,862</u>	<u>\$ (40,288)</u>	<u>\$ (90)</u>	<u>\$ 3,771,484</u>

	Beginning Balance	1996		Ending Balance
		Additions	Deletions	
Land	\$ 655,241	\$ -	\$ -	\$ 655,241
Land Improvements	208,693	-	-	208,693
Building	3,208,920	4,613	-	3,213,533
Equipment	1,774,575	96,101	(13,544)	1,857,132
Total	5,847,429	100,714	(13,544)	5,934,599
Accumulated Depreciation	(1,747,636)	(386,461)	11,360	(2,122,737)
Property and equipment, net	<u>\$ 4,099,793</u>	<u>\$ (285,747)</u>	<u>\$ (2,184)</u>	<u>\$ 3,811,862</u>

(7) Accrued Compensated Absences

Employees of the System are entitled to receive compensation for all accrued but unused vacation time and one-half of all unused sick leave earned after January 1, 1984 upon termination of employment. These accrued compensated absences as of June 30, 1997 and 1996 totaled \$771,943 and \$724,466, respectively, and are included as Administrative Expenses Payable.

(8) Analysis of Changes in Reserve Balances

The System maintains three reserve accounts. The reserves are defined as follows:

- (a) Participants' contributions - accounts for assets contributed by each participant,
- (b) Interest accumulations - accounts for interest credited to each participant's account, and
- (c) Other future benefits - accounts for all assets not otherwise specifically provided for in items (a) and (b) above.

State Employees' Retirement System Statements of Changes in Reserve Balances Years ended June 30, 1997 and 1996				
	Participants' contributions	Interest accumulations	Other future benefits	Total Reserve Balances
Balance at June 30, 1995, as previously reported	\$ 1,120,553,065	\$ 620,397,583	\$ 2,182,145,917	\$ 3,923,096,565
Restatement to record net appre- ciation in fair value of investments	-	-	607,317,257	607,317,257
Balance at June 30, 1995, as restated	\$ 1,120,553,065	\$ 620,397,583	\$ 2,789,463,174	\$ 4,530,413,822
Add (deduct):				
Excess of revenue over expenses	117,695,415	-	530,571,120	648,266,535
Reserve transfers:				
Accumulated contributions of members who retired during the year, less contributions of annuitants returning to active status	(26,211,768)	-	26,211,768	-
Interest credited to members' accounts	-	81,249,626	(81,249,626)	-
Balance at June 30, 1996	\$ 1,212,036,712	\$ 701,647,209	\$ 3,264,996,436	\$ 5,178,680,357
Add (deduct):				
Excess of revenue over expenses	\$ 126,018,256	\$ -	\$ 743,328,612	\$ 869,346,868
Reserve transfers:				
Accumulated contributions of members who retired during the year, less contributions of annuitants returning to active status	(26,789,862)	-	26,789,862	-
Interest credited to members' accounts	-	91,484,477	(91,484,477)	-
Balance at June 30, 1997	\$ 1,311,265,106	\$ 793,131,686	\$ 3,943,630,433	\$ 6,048,027,225

(9) Social Security Contribution Fund and Administrative Expenses

By state statute, the System is designated as the state social security administrator for the State of Illinois. In this capacity, the System has maintained and operated a separate state agency fund for the collection of social security and medicare contributions for wages paid prior to January 1, 1987. Effective January 1, 1987, the responsibility for the collection and transmittal of Social Security contributions for state agencies and participating state employees was transferred from the System to the Office of the Comptroller of the State of Illinois. As of that same date, political subdivisions of the state became responsible for their own remittance of social security contributions to the federal government. The balance in this fund is being maintained for final settlement of open years. There were no transactions affecting this fund during fiscal year 1997. There were two transactions affecting this agency fund during fiscal year 1996, one deposit and one disbursement.

The changes in the assests and liabilities of the agency fund were as follows:

	1997				1996			
	Balance July 1, 1996	Additions	(Deductions)	Balance June 30, 1997	Balance July 1, 1995	Additions	(Deductions)	Balance June 30, 1996
Assests								
Cash	\$ 5,275	\$ 0	\$ 0	\$ 5,275	\$ 113,323	\$ 100,000	\$ 208,048	\$ 5,275
Liabilities								
Amount held for Social Security								
Remittances	\$ 5,275	\$ 0	\$ 0	\$ 5,275	\$ 113,323	\$ 100,000	(\$208,048)	\$ 5,275

The dollar amount of transactions for this agency fund are not material to, and therefore, are not included with, the financial statements of the System.

Administrative expenses for the Contribution Fund are appropriated annually by the State Legislature.

	1997	1996
Personal services	\$ 33,268	\$ 31,343
Employer retirement pickup	1,331	1,254
Retirement contributions	1,651	1,494
Social Security contributions	2,531	2,358
Contractual services	21,832	23,195
Travel	1,499	1,273
Commodities	359	343
Electronic data processing	700	700
Telecommunications	453	494
Total	\$ 63,624	\$ 62,454

(10) Effect of Change in Accounting Principle

Effective July 1, 1996, the System elected to adopt the provisions of GASB Statement No. 25, "Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans". The provisions of this statement require restatement of prior year balances for the effect of changing from reporting investments at cost to reporting investments at fair value. The effect of the change in accounting principle on the net assets held in trust for pension benefits as of June 30, 1995, is shown below:

June 30 1995, net assets held in trust for pension benefits, as previously reported	\$3,923,096,565
Restatement to record net appreciation in fair value of investments	607,317,257
June 30, 1995, net assets held in trust for pension benefits, as restated	\$4,530,413,822

The adoption had the effect of increasing net appreciation of the fair value of assets by \$376,744,144 and \$174,394,048 for the years ended June 30, 1997 and 1996, as compared to the net appreciation that would have been recognized under the previous accounting method.

(11) Subsequent Event

On July 15, 1997, Governor Jim Edgar signed House Bill 110 into law as Public Law 90-0065. This comprehensive bill contained numerous provisions affecting the System. The most significant change, however, involved the System's transition from a step rate retirement benefit formula to a flat rate retirement benefit formula covering nearly 62,000 members of the System. The increased retirement benefit formula is applicable to all eligible members with a retirement effective date on and after January 1, 1998. The aggregate cost impact of House Bill 110, along with several other minor pieces of legislation signed into law subsequent to June 30, 1997, had the effect of increasing the System's actuarial liability by approximately \$1.1 billion.

Schedule of Funding Progress ⁽¹⁾

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) -Projected Unit Credit (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage Covered Payroll ((b-a)/c)
6/30/97	\$6,048,027,225	\$7,548,207,778	\$1,500,180,553	80.1%	3,003,628,000	49.9%

Schedule of Employer Contributions ⁽¹⁾

Year Ended June 30	Annual Required Contribution per GASB Statement No. 25 ⁽²⁾	Percentage Contributed	(A) Annual Required Payroll Contribution per State Statute ⁽³⁾	(B) State Pension Fund Contribution	(A) + (B) Total Required State Contribution	Percentage Contributed
1997	\$211,125,012	74.9%	\$149,070,058	\$8,489,800	\$157,559,858	100%

(1) The required Schedules of Funding Progress and Employer Contributions are to include information for the current year and as many of the prior years as information according to the parameters stipulated in Governmental Accounting Standards Board Statement No. 25 entitled "Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans," issued November 1994, (GASB Statement No. 25) is available. The schedules should not include information that does not meet the parameters. The System has only one year of information which meets the requirements of the parameters, therefore, that is all the information which is presented.

(2) This amount includes both payroll and non-payroll employer required contributions.

(3) Employer required contribution determined in accordance with SB533 (P.A. 88-0593). This amount reflects only payroll required contributions.

Notes to Required Supplementary Information

Valuation date June 30, 1997

Actuarial cost method Projected Unit Credit

Amortization method:

- a) For GASB Statement No. 25 reporting purposes Level percent of payroll
- b) Per state statute 15-year phase-in to a level percent of payroll until a 90% funding level is achieved

Remaining amortization period:

- a) For GASB Statement No. 25 reporting purposes 40 years, open
- b) Per state statute 48 years, closed

Asset valuation method Fair Value

Actuarial assumptions:

- Investment rate of return 8.5 percent
- Projected salary increases 0.5 to 4.7 percent, based upon member's age
- Assumed inflation rate 3.5 percent
- Group size growth rate 0.0 percent
- Payroll growth rate for FY98 5.8 percent
- Post-retirement increase 3.0 percent - compounded
- Mortality table 1983 Group Annuity Mortality Table for males and females.
Five percent of deaths amongst active employees are assumed to be in the performance of their duty.

Based upon the results of the actuarial experience review, several changes were made to the actuarial assumptions. These changes had the effect of decreasing the actuarial liability and the related unfunded actuarial liability by \$380 million and were primarily the result of adjustments to expected salary increases and investment returns.

SYSTEM TRUST FUND

SUMMARY OF REVENUES BY SOURCE

Years Ended June 30, 1997 and 1996

	<u>1997</u>	<u>1996</u>
Contributions:		
Participants	\$ 142,716,669	\$ 135,028,062
Repayments of contributions refunded	726,330	513,422
Interest received from participants	2,240,544	1,676,442
ERI service purchase	-	2,111
Total participants contributions	<u>\$ 145,683,543</u>	<u>\$ 137,220,037</u>
Employing state agencies	\$ 149,689,714	\$ 137,574,134
State Pension Fund appropriation	8,489,800	8,823,800
Total state contributions and appropriations	<u>158,179,514</u>	<u>146,397,934</u>
Investments:		
Net investments income	\$ 213,670,347	\$ 193,491,522
Interest earned on cash balances	3,346,821	2,265,444
Net appreciation in fair value of investments	735,593,840	540,406,296
Total investment revenue	<u>\$ 952,611,008</u>	<u>\$ 736,163,262</u>
Total Revenue	<u>\$1,256,474,065</u>	<u>\$1,019,781,233</u>

SYSTEM TRUST FUND

**SUMMARY SCHEDULE OF CASH RECEIPTS
AND DISBURSEMENTS**

Years Ended June 30, 1997 and 1996

	<u>1997</u>	<u>1996</u>
Cash balance, beginning of year	\$ 51,602,122	\$ 19,796,262
Receipts:		
Member contributions	140,748,663	133,369,459
Employer contributions	149,483,893	134,490,179
State Pension Fund contribution	8,489,800	8,823,800
Transfers from Illinois State Board of Investment	99,000,000	120,000,000
Interest income on cash balance	3,250,064	2,141,707
Claims receivable payments	2,857,949	2,462,652
Installment payments - prior service credit	1,491,638	1,307,067
Other	56,470	68,556
Total cash receipts	<u>\$ 405,378,477</u>	<u>\$ 402,663,420</u>
Disbursements:		
Annuity payments:		
Retirement annuities	\$ 298,566,959	\$ 286,409,926
Widow's annuities	2,342,944	2,423,994
Survivors' annuities	32,988,051	30,653,385
Death benefits	11,659,752	10,552,673
Disability benefits	23,151,078	21,675,498
Refunds	13,133,477	13,828,892
Administrative expenses	5,660,193	5,313,192
Total cash disbursements	<u>\$ 387,502,454</u>	<u>\$ 370,857,560</u>
Cash balance, end of year	<u>\$ 69,478,145</u>	<u>\$ 51,602,122</u>

ACTUARIAL SECTION

- Actuary's Report
- Introduction
- Actuarial Cost Method and Summary of Major Actuarial Assumptions
- Valuation Results
- Schedule of Active Member Valuation Data
- Short-Term Solvency Test
- Summary of Accrued and Unfunded Accrued Liabilities
(Analysis of Funding)
- Schedule of Retirants Added To and Removed From Rolls
- Schedule of Survivors' Annuitants Added To and Removed From Rolls
- Schedule of Disability Recipients Added To and Removed From Rolls
- Reconciliation of Unfunded Actuarial Liability



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October 14, 1997

Board of Trustees and Executive Secretary
State Employees' Retirement System of Illinois
P. O. Box 19255
2101 S Veterans Parkway
Springfield, Illinois 62794-9255

Actuarial Certification

We have completed the annual actuarial valuation of the assets and liabilities of the State Employees' Retirement System of Illinois as of June 30, 1997.

Pursuant to the law establishing the System, the actuary shall investigate the experience under the System at least once every five years*. Watson Wyatt Worldwide, as the actuary, completed such a review for the seven-year period ending June 30, 1997 and recommended assumptions which were adopted by the Board effective June 30, 1997. These assumptions are used for the current valuation. We believe that, in the aggregate, these assumptions relate reasonably to the past and anticipated experience of the plan.

* Senate Bill 114 amended the Pension Code to provide for the next five-year review period to begin June 30, 1997 (instead of June 30, 1995).

A contribution rate has been determined under the Projected Unit Credit Cost Method, providing for a 90% funding of total actuarial liabilities by fiscal year 2045 as required by 40 ILCS Section 5/14-131(e). Future contribution rates through fiscal year 2009 are fixed percentages under HB110. A level contribution rate is determined for fiscal year 2010 through 2045. The required contribution rates and amounts for fiscal year 1999 are as follows:

	Total	Net**
Required Rate	9.800%	9.528%
Required Contribution	\$305,858,000	\$297,368,200
** These values reflect the \$8,489,800 received from the unclaimed property fund for fiscal year 1997.		



Board of Trustees and Executive Secretary
October 14, 1997
Page 2

For purposes of determining contribution rates, the market value of assets as reported by the Illinois State Board of Investment are used for the 1997 fiscal year. Assets have been projected using market value for subsequent fiscal years. The liabilities have been valued based on employee data which is supplied by the administrative staff of the System and verified by the System's auditor. We have made additional tests to ensure its accuracy.

The contribution rate determined complies with requirements of Senate Bill 533.

Watson Wyatt & Company

By: Kristin Stocke
Kristin Stocke
Actuarial Analyst

By: Denise Patterson
Denise Patterson
Fellow of the Society of Actuaries

By: William J. Miner
William J. Miner
Fellow of the Society of Actuaries

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INTRODUCTION

The System receives contributions from several sources which can be considered as employer contributions, with the largest source being the regular state appropriation. The System also receives an annual appropriation from the State Pension Fund.

Annually, the System's actuarial consultant prepares a valuation of the liabilities and reserves of the System in order to make a determination of the amount of contributions required from the state. The amortization period required by Illinois state statutes is not in accordance with the parameters defined in Governmental Accounting Standards Board Statement No. 25. In fiscal years 1997 and 1996, the actuary has determined the required employer contribution rate and amount using the projected unit credit cost method. Fiscal Year 1996 marked the first year that, based upon the state's actual funding method described below, the System, did receive the minimum actuarially determined employer contribution amount.

The employers' contribution amount, together with members' contributions, income from investments and any other income received by the System, shall be sufficient to meet the cost of maintaining and administering the System on a funded basis in accordance with actuarial reserve requirements, pursuant to Chapter 40, Section 5/14-131 of the Illinois Compiled Statutes. The statutes define "actuarial reserves" as "An accumulation of funds in advance of benefit payments which will be sufficient with respect to each member and his beneficiaries, if any, to pay the prescribed benefits, computed according to the actuarial tables, without further contributions by or on behalf of the member."

In August, 1994, Governor Edgar signed Senate Bill 533 (SB533) into law as Public Act 88-0593, effective July 1, 1995. In addition, Public Act 90-0065 (HB110) was signed into law by Governor Jim Edgar on July 15, 1997. Not only did these comprehensive bills dramatically increase state employee pension benefits, effective January 1, 1998, they also mandated an increase of employer retirement contributions. In general, state law governing the System under SB533 and HB110 provides that:

- For fiscal years 1998 through 2010, the contribution to the System, as a percentage of the payroll shall be increased in equal annual increments so that by fiscal year 2010, the contribution rate is at the same level as the contribution rate for fiscal years 2011 through 2045. In accordance with HB110, State contribution rates for fiscal years 1999 through 20009 will not be less than the following schedule:

Fiscal Year	Statutory Rate	Fiscal Year	Statutory Rate
1999	9.8%	2005	11.0%
2000	10.0	2006	11.2
2001	10.2	2007	11.4
2002	10.4	2008	11.6
2003	10.6	2009	11.8
2004	10.8		

- For fiscal years 2011 through 2045, the minimum contribution to the System for each fiscal year shall be an amount determined to be sufficient to bring the total assets of the System up to 90% of the total actuarial liabilities of the System by the end of fiscal year 2045. In making these determinations, the required contribution shall be calculated each year as a level percentage of payroll over the years remaining to and including fiscal year 2045 and shall be determined under the projected unit credit actuarial cost method.

Beginning in fiscal year 2045, the minimum contribution to the System for each fiscal year shall be the amount needed to maintain the total assets of the System at 90% of the total actuarial liabilities of the System.

Most importantly, the SB533 funding legislation also provided for the establishment of a continuing appropriation of the required employer contributions to the System. This has, in effect, removed the appropriation of these funds from the annual budgetary process. Although long-term in nature, we believe that this legislation has been an extremely positive step forward which will ensure the long-term financial integrity of the state's retirement systems including the State Employees' Retirement System.

ACTUARIAL COST METHOD AND SUMMARY OF MAJOR ACTUARIAL ASSUMPTIONS

For fiscal years 1997 and 1996, a projected unit credit normal cost method is used. Under this method, the projected pension at retirement age is first calculated and the value thereof at the individual member's current or attained age is determined. The normal cost for the member for the current year is equal to the value so determined divided by the member's projected service at retirement. The normal cost for the plan for the year is the sum of the individual normal costs.

Actuarial gains and losses are recognized immediately in the unfunded actuarial liability of the System. For purposes of determining future employer contributions, however, the actuarial gains and losses are amortized in accordance with the funding plan established in state law by Public Act 88-0593, as amended.

For ancillary benefits for active members, in particular disability benefits, death and survivor benefits, termination benefits, and the post-retirement increments, the same procedure as outlined above is followed.

A description of the actuarial assumptions utilized for FY-97 and FY-96 follows:

Dates of Adoption: The Projected Unit Credit Normal Cost Method was adopted June 30, 1989; all other assumptions were adopted June 30, 1997.

Mortality: FY97 - 1983 Group Annuity Mortality Table for males (with a one-year setback) and females (with no setback). Five percent of deaths amongst active employees are assumed to be in the performance of their duty.

FY96 - 1986 Projected Experience Table, a table based on experience underlying the 1971 Group Annuity Mortality Table, without margins, with a projection for mortality improvements to 1986. Five percent of deaths amongst active employees are assumed to be in the performance of their duty.

Interest: FY97 - 8.5% per annum, compounded annually; FY96 - 8% per annum, compounded annually

Termination: Illustrative rates follow. It is assumed that terminated employees will not be rehired.

Age	FY 97		Age	FY 96	
	Rate			Rate	
	Males	Females		Males	Females
20	.159	.339	20	.188	.377
25	.107	.129	25	.126	.144
30	.073	.086	30	.085	.096
35	.052	.065	35	.062	.072
40	.040	.050	40	.047	.056
45	.031	.037	45	.038	.041
50	.027	.027	50	.032	.030
55+	.026	.027	55+	.030	.030

Salary Increases: Illustrative rates of increase per annum, compounded annually:

1997				1996			
Age	Males & Females	Components		Age	Males & Females	Components	
		Merit	Inflation			Merit	Inflation
20	8.2%	4.7%	3.5%	20	9.2%	4.7%	4.5%
25	7.7	4.2	3.5	25	8.7	4.2	4.5
30	7.2	3.7	3.5	30	8.2	3.7	4.5
35	6.7	3.2	3.5	35	7.7	3.2	4.5
40	6.2	2.7	3.5	40	7.2	2.7	4.5
45	5.7	2.2	3.5	45	6.7	2.2	4.5
50	5.2	1.7	3.5	50	6.2	1.7	4.5
55	4.7	1.2	3.5	55	5.7	1.2	4.5
60	4.2	.7	3.5	60	5.2	0.7	4.5
65	4.0	.5	3.5	65	5.0	0.5	4.5

Retirement Rates: Listed below are rates of retirement that vary by age:

1997			1996		
Age	General Employees	Alternative Formula Employees	Age	General Employees	Alternative Formula Employees
50-54	--	10.0%	50-54	-- %	20.0%
55-59	10.0%	15.0	55-59	10.0	20.0
60	12.5	20.0	60	25.0	20.0
61	15.0	22.0	61	15.0	20.0
62	17.5	24.0	62	20.0	20.0
63	20.0	26.0	63	15.0	20.0
64	22.5	28.0	64	15.0	20.0
65	25.0	30.0	65	40.0	40.0
66-69	25.0	30.0	66-69	25.0	30.0
70	100.0	100.0	70	100.0	100.0

*An additional 10% are assumed to retire in the year in which the employee completes 30 years of service. The rates apply only to employees who have fulfilled the service requirement necessary for retirement at any given age.

Assets: Assets available for benefits are valued at fair value (market).

Expenses: As estimated and advised by SERS staff, based on current expenses with an allowance for expected increases.

Marital Status: 85% of employees are assumed to be married.

Spouse's Age: The female spouse is assumed to be three years younger than the male spouse.

In addition to the above, other assumptions used include disability incidence, recovery from disability, mortality of disabled lives, remarriage rates, ages, and numbers of children and Social Security benefit levels.

Postretirement Benefit Increases: 3% annually, compounded

Experience Review: Pursuant to state law, the System had the actuary's perform this review for the seven year period ended June 30, 1997. In the future, an Experience Review will be performed every five years.

VALUATION RESULTS

Actuarial Liability (Reserves)	FY-97	FY-96
For Annuitants:		
For Benefit Recipients:		
Retirement Annuities	\$ 3,121,050,296	\$ 2,990,765,595
Survivor Annuities	330,813,031	309,524,925
Disability Annuities	99,466,722	119,446,683
Deferred:		
Retirement Annuities	3,227,275	2,491,486
Survivor Annuities	9,114,052	9,538,982
Total	\$ 3,563,671,376	\$3,431,767,671
For Inactive Members:		
Eligible for Deferred Vested Pension Benefits	115,623,450	113,874,700
Eligible for Return of Contributions Only	11,410,379	10,973,814
Total	\$ 127,033,829	\$ 124,848,514
For Active Members	\$ 3,857,502,573	\$ 3,834,276,250
Actuarial Present Value of Credited Projected Benefits	7,548,207,778	7,390,892,435
Assets, Fair Value	6,048,027,225	5,178,680,357
Unfunded Actuarial Present Value of Credited Projected Benefits	\$ 1,500,180,553	\$ 2,212,212,078

SCHEDULE OF ACTIVE MEMBER VALUATION DATA

Valuation Date	Number	Annual Payroll	Annual Average Pay	% Increase In Average Pay
6/30/88	74,923	\$1,953,960,000	\$26,080	6.8%
6/30/89	76,651	2,106,121,000	27,477	5.4
6/30/90	79,211	2,270,303,000	28,661	4.3
6/30/91	81,023	2,461,352,000	30,378	6.0
6/30/92	77,194	2,439,708,000	31,605	4.0
6/30/93	77,146	2,450,350,000	31,763	0.5
6/30/94	78,440	2,623,793,000	33,450	5.3
6/30/95	78,796	2,756,072,000	34,977	4.6
6/30/96	79,212	2,871,501,000	36,251	3.6
6/30/97	79,697	3,003,628,000	37,688	4.0

SHORT-TERM SOLVENCY TEST

A short-term solvency test is one means of checking a system's progress under its funding program. In a short-term solvency test, the plan's present assets (primarily cash and investments) are compared with: 1) active member contributions on deposit; 2) the liabilities for future benefits to present retired lives; and 3) the liabilities for service already rendered by active members. In a system that has been following level percent of payroll financing, the liabilities for service already rendered by active members (liability 3) should be partially covered by the remainder of present assets. If the system continues using level cost financing, the funded portion of liability 3 will increase over time, although it is very rare for a system to have its liability 3 fully funded.

Computed Actuarial Values (in thousands of dollars)

Fiscal Year	Member Contributions	Current Retirees and Beneficiaries	Active and Inactive Members, Employer Financed Portion	Net Assets Available For Benefits*	Percentage of Actuarial Values Covered by Net Assets Available		
					(1)	(2)	(3)
1988	\$ 699,190	\$ 1,546,828	\$ 1,395,561	\$ 2,381,806	100.0%	100.0%	9.7%
1989	757,180	1,653,880	1,341,074	2,580,199	100.0	100.0	12.6
1990	823,025	1,932,126	1,782,923	2,795,567	100.0	100.0	2.3
1991	897,690	2,078,059	1,974,131	2,981,415	100.0	100.0	0.3
1992	867,003	3,047,923	1,685,841	3,278,248	100.0	79.1	0.0
1993	939,207	3,221,630	1,883,628	3,496,486	100.0	79.4	0.0
1994	1,029,390	3,242,857	2,229,874	3,721,891	100.0	83.0	0.0
1995	1,120,553	3,387,197	2,480,720	3,923,097	100.0	82.7	0.0
1996	1,212,037	3,431,768	2,747,087	5,178,680	100.0	100.0	19.5
1997	1,311,265	3,563,672	2,673,271	6,048,027	100.0	100.0	43.9

*Net assets are reported at fair value for fiscal years 1997 and 1996. All other years presented are reported at cost (book value).

SUMMARY OF ACCRUED AND UNFUNDED ACCRUED LIABILITIES (ANALYSIS OF FUNDING)

In an inflationary economy, the value of the dollar decreases. This environment results in employees' pay and retirement benefits increasing in dollar amounts resulting in unfunded accrued liabilities which increase in dollar amounts, all at a time when the actual substance of these items may be decreasing. Looking at just the dollar amounts of unfunded accrued liabilities can be misleading. The ratio of the unfunded accrued liabilities to active employee payroll provides an index which clarifies understanding. The smaller the ratio of unfunded liabilities to active member payroll, the stronger the system. Observation of this relative index over a period of years will give an indication of whether the system is becoming financially stronger or weaker.

Fiscal Year	Total Actuarial Liability	Net Assets*	(in thousands of dollars)		Member Payroll	Unfunded Actuarial Liability as a % of Member Payroll
			Net Assets as a % of Actuarial Liability	Total Unfunded Actuarial Liability		
1988	\$ 3,641,579	\$ 2,381,806	65.4%	\$ 1,259,773	\$ 1,953,960	64.4%
1989	3,752,134	2,580,199	68.8	1,171,935	2,106,121	55.6
1990	4,538,074	2,795,567	61.6	1,742,507	2,270,303	76.8
1991	4,949,880	2,981,415	60.2	1,968,465	2,461,352	80.0
1992	5,600,767	3,278,248	58.5	2,322,519	2,439,708	95.2
1993	6,044,465	3,496,486	57.8	2,547,979	2,450,350	104.0
1994	6,502,121	3,721,891	57.2	2,780,230	2,623,793	106.0
1995	6,988,470	3,923,097	56.1	3,065,373	2,756,072	111.2
1996	7,390,892	5,178,680	70.1	2,212,212	2,871,501	77.0
1997	7,548,208	6,048,027	80.1	1,500,181	3,003,628	49.9

*Net assets are reported at fair value for fiscal years 1997 and 1996. All other years presented are reported at cost (book value).

SCHEDULE OF RETIRANTS ADDED TO AND REMOVED FROM ROLLS

<u>Fiscal Year</u>	<u>Beginning Balance</u>	<u>Additions</u>	<u>(Removals)</u>	<u>Ending Balance</u>
1988	22,529	1,506	(997)	23,038
1989	23,038	1,532	(998)	23,572
1990	23,572	1,356	(1,064)	23,864
1991	23,864	1,428	(1,009)	24,283
1992	24,283	5,270	(1,052)	28,501
1993	28,501	974	(1,167)	28,308
1994	28,308	944	(1,123)	28,129
1995	28,129	1,058	(1,285)	27,902
1996	27,902	1,167	(1,169)	27,900
1997	27,900	1,017	(1,227)	27,690

**SCHEDULE OF SURVIVORS' ANNUITANTS
ADDED TO AND REMOVED FROM ROLLS**

<u>Fiscal Year</u>	<u>Beginning Balance</u>	<u>Additions</u>	<u>(Removals)</u>	<u>Ending Balance</u>
1988	8,015	617	(336)	8,296
1989	8,296	578	(375)	8,499
1990	8,499	525	(395)	8,629
1991	8,629	576	(386)	8,819
1992	8,819	564	(432)	8,951
1993	8,951	605	(441)	9,115
1994	9,115	569	(439)	9,245
1995	9,245	630	(474)	9,401
1996	9,401	583	(522)	9,462
1997	9,462	588	(485)	9,565

**SCHEDULE OF DISABILITY RECIPIENTS
ADDED TO AND REMOVED FROM ROLLS**

<u>Fiscal Year</u>	<u>Beginning Balance</u>	<u>Additions</u>	<u>(Removals)</u>	<u>Ending Balance</u>
1988	1,577	1,779	(1,820)	1,536
1989	1,536	1,713	(1,791)	1,458
1990	1,458	1,724	(1,681)	1,501
1991	1,501	2,027	(1,945)	1,583
1992	1,583	2,057	(2,081)	1,559
1993	1,559	2,005	(1,921)	1,643
1994	1,643	2,094	(2,029)	1,708
1995	1,708	2,085	(1,992)	1,801
1996	1,801	1,992	(1,923)	1,870
1997	1,870	2,097	(1,991)	1,976

RECONCILIATION OF UNFUNDED ACTUARIAL LIABILITY

	FY-97	FY-96
Unfunded Liability, Beginning of Fiscal Year, as previously reported	\$ 2,212,212,078	\$ 3,065,373,100
Restatement due to change in method used to determine actuarial value of assets	-	(607,317,257)
Unfunded Liability, Beginning of Fiscal Year, as restated	2,212,212,078	2,458,055,843
Contributions Due		
Interest on the Unfunded Liability	176,976,966	245,229,848
Total Normal Cost	104,959,358	99,623,290
Participants (includes Repayment of Refunds)	145,683,543	137,220,037
Interest on Normal Cost	9,832,842	9,291,479
Total Due	\$ 437,452,709	\$ 491,364,654
Contributions Paid		
Participants (includes Repayment of Refunds)	\$ 145,683,543	\$ 137,220,037
Employing State Agencies and Appropriations	158,179,514	146,397,934
Interest on Contributions	11,920,695	11,126,471
Total Paid	\$ 315,783,752	\$ 294,744,442
Increase in the Unfunded Liability	\$ 121,668,957	\$ 196,620,212
Actuarial (Gains) Losses		
(a) Incidence of Disability	\$ (504,210)	\$ (716,417)
(b) In-Service Mortality	18,937,208	15,642,586
(c) Retiree Mortality	5,846,692	7,460,269
(d) Disabled Mortality	(211,311)	(348,330)
(e) Termination of Employment	98,932,797	39,323,776
(f) Salary Increases	(65,121,542)	(63,804,332)
(g) Investment Income	(541,583,072)	(251,369,719)
(h) Other	29,897,335	(14,257,761)
Total Actuarial (Gain) Loss	\$ (453,806,103)	\$ (268,069,928)
Non-recurring items:		
Adjustment to reflect adoption of GASB Statement No. 25, recognition of unrealized (gains) losses, net	-	(174,394,049)
Changes in Actuarial Assumptions	(379,894,379)	-
Total Increase (Decrease) in Actuarial Liability	= \$ (712,031,525)	\$ (245,843,765)
Unfunded Liability, End of Fiscal Year	\$ 1,500,180,553	\$ 2,212,212,078

INVESTMENT SECTION

- Investment Report
- Investment Portfolio Summary
- Analysis of Investment Performance
- Additional Investment Information

INVESTMENT REPORT

By state law the System's investment function is managed by the Illinois State Board of Investment (ISBI). The ISBI was created in 1969 to provide a means of centralizing the investment management function for public employee pension funds and retirement systems operating in the state. In addition to the assets of the State Employees' Retirement System, the ISBI also manages the investment function for the General Assembly and Judges' Retirement Systems. All ISBI investments are accounted for in a commingled fund (ISBI Fund). As of June 30, 1997, total net assets under management valued at market, amounted to \$6.328 billion. Of the total market value of assets under management, \$5.966 billion or 94% represented assets of the State Employees' Retirement System.

Management Approach

The ISBI manages its investments in accordance with the "prudent person rule" as adopted by the Illinois General Assembly in 1982. The ISBI has established a long-range investment policy which, in line with the prudent person rule, affirms that the ISBI Fund's objective is to provide the greatest possible long-term benefits through maximization of the total return of the ISBI Fund, within prudent risk parameters. Further, it is the ISBI's philosophy that the assets owned by the participating systems and managed by the ISBI are held for the exclusive purpose of providing benefits to the participants and annuitants of the respective retirement systems and their beneficiaries. In line with this philosophy, the ISBI from time to time evaluates its asset allocation which is considered by many to be the single most important factor in pension investment management. The three major asset classes are: bonds, equities and cash; with smaller positions being allocated to real estate, venture capital and other alternative investments.

The investment policy of the ISBI establishes asset allocation targets and ranges for each asset class, selected to achieve overall risk and return objectives. The policy is monitored by ISBI and implemented by allocations to investment managers with assignments to invest in specific asset classes, and with specific selection styles and methodologies.

Investment Results

Led by U.S. stocks, capital markets posted impressive gains during fiscal 1997. U.S. and international stocks achieved double digit returns for the period. A good environment for initial public offerings (IPO's) also led to strong returns for many private equity partnerships. Fixed income, boosted by interest rates trending slightly downward, posted returns somewhat higher than the coupon return. Real estate also experienced some appreciation, and an overall double digit return for the fiscal year.

The ISBI earned a total rate of return for fiscal 1997, net of expenses, of 18.8%, well ahead of its long-term objectives of earning 4.5% above the inflation rate and exceeding the 8.5% assumed actuarial interest rate. The return was in line with the policy-weighted benchmark return of 18.8%. Over the five-year time period, the ISBI is ahead of its investment objectives. The average annual returns for the three- and five-year periods ended June 30, 1997, were 16.5% and 13.0%, respectively. Over the 15-year period since the adoption of the prudent person legislation, the ISBI has produced a compounded annual rate of return, net of expenses and charges, of 13.0%, and its net assets have increased by \$5.3 billion.

Domestic Equities

For the twelve months ended June 30, 1997, equity markets soared. The S&P 500 Index increased 34.6%, and the BARRA All-U.S. Index, a broader representation of the domestic market, rose 30.0%. Small capitalization stocks, as measured by the Russell 2000 Index, grew at a significantly smaller rate of 16.3%. Within that context, the ISBI's domestic equity portfolio, which is all managed by external investment firms, earned a return of 26.3%. The lag reflects the ISBI commitment to both large and smaller capitalization stocks, whose performance lagged behind that of the large stocks which dominate the indices.

The ISBI's domestic stock portfolio performance versus the S&P 500 Index is as follows:

	1 Year	3 Years	5 Years
ISBI	26.3%	24.5%	18.3%
S&P 500	34.6	28.8	19.7

Global/International Equities

Foreign stock markets overall had strong returns for the fiscal year, although lagging the U.S. market. A strengthening dollar, however, further dampened foreign stock returns for U.S. investors. The Morgan Stanley Europe Australia Far East Index ("MSCI EAFE") earned 13.2% in U.S. dollar terms for the fiscal year ended June 30. The Morgan Stanley World Index ("MSCI World"), which includes the U.S. market, increased 22.8% in dollar terms for the same period.

All foreign security accounts are managed by external investment firms. "Global" managers have the discretion to invest in both domestic as well as foreign securities, while "international" managers are limited to non-U.S. securities; thereby assuring a certain level of diversification. For the fiscal year the ISBI's global managers slightly lagged the MSCI World Index, earning 20.9%. The ISBI's international portfolio outperformed its benchmark, increasing 18.3%, compared to 13.2% for the EAFE Index.

Comparative average annual rates of return for the Global/International equities portfolio versus the market index benchmarks is shown below:

	1 Year	3 Years	5 Years
Global Equities			
ISBI	20.9%	16.1%	15.7%
MSCI World Index	22.8	17.6	16.2
International Equities			
ISBI	18.3%	13.5%	13.9%
MSCI EAFE Index	13.2	9.4	13.2

Fixed Income

During fiscal 1997, U.S. fixed income markets showed some strength, with interest rates heading somewhat lower. The Lehman Aggregate Bond Index earned 8.2% for the 12-month period, while high yield bonds, as represented by the Merrill Lynch High Yield Index, did better with a return of 14.3%.

Substantially all fixed income assets are managed internally by ISBI except approximately \$87 million allocated to an external high yield bond manager. The internal account outperformed the Lehman Aggregate Bond index, with a return of 9.2%. Higher returns from the external high yield manager resulted in a total fixed income return of 9.5%.

Comparative average annual rates of return for the total fixed income portfolio versus the market index benchmark is shown below:

	1 Year	3 Years	5 Years
ISBI	9.5%	9.3%	9.0%
Shearson Lehman Aggregate	8.2	8.5	7.1

Real Estate

All of the ISBI's investments in real estate are passive and are represented by interests in limited partnerships, trusts, and other forms of pooled investments. Real estate values strengthened during fiscal 1997, and investments owned by the ISBI's portfolio earned a 12.8% rate of return. The ISBI believes that the portfolio is well-positioned for steady performance going forward.

Average annual rates of return for the combined real estate portfolio compared to the market benchmark for unleveraged institution grade property returns is shown below:

	<u>1 Year</u>	<u>3 Years</u>	<u>5 Years</u>
ISBI	12.8%	6.3%	0.5%
NCRIEF	11.0	9.2	5.0

Alternative Investments

The alternative investments portfolio consists of passive interests in limited partnerships and other commingled vehicles that invest capital, management buyouts and other private placement activities. The portfolio's largest investment is with the Kohlberg Kravis Roberts (KKR) leveraged buyout limited partnership, which accounts for almost 75% of this category. Fiscal 1997 was a good year for alternative investments. A strong initial public offering (IPO) market allowed a number of portfolio companies to gain access to the auction markets, thereby producing liquidity and/or actual cash returns to ISBI. Overall, the category earned 38.8% for the fiscal year.

The ISBI made commitments totalling \$80 million to five new limited partnerships in fiscal 1997. Although the current allocation to this asset class is not significantly below the long-term target, in order to maintain the level of investment, new commitments are necessary over time to balance anticipated distribution from maturing partnerships. The new partnerships are Cornerstone IV; Frontenac VII; KKR 1996; Mesirow VII; and Weiss, Peck & Greer IV. Funds for these future commitments will come from cash flow generated from existing alternative investments.

Management Expenses

Total ISBI operating expenses, primarily fees to external managers, for the fiscal year were \$14,245,218, compared to \$15,511,389 for the previous fiscal year. The expense ratio (expenses divided by average net assets under management) was .25% in fiscal 1997, compared to .30% in fiscal 1996.

Additional Information

For additional information regarding the System's investment function, please refer to the Annual Report of the Illinois State Board of Investment, June 30, 1997. A copy of the report can be obtained from the ISBI at 180 North LaSalle Street, Suite 2015, Chicago, Illinois 60601.

INVESTMENT PORTFOLIO SUMMARY

	June 30, 1997		June 30, 1996	
	Market Value	Percentage	Market Value	Percentage
Fixed Income ¹	\$ 1,832,294,575	29.0%	\$ 1,662,844,282	30.6%
Equities	2,470,905,061	39.0	2,051,373,589	37.7
Foreign Equities	1,019,434,063	16.1	560,500,860	10.3
Real Estate	252,606,430	4.0	243,308,942	4.5
Non-Marketable ²	306,053,788	4.8	274,289,456	5.0
Forward Foreign				
Exchange Contracts	1,008,282	-	1,154,317	-
Options	4,465,309	.1	-	-
Cash equivalents ³	441,369,634	7.0	643,344,999	11.9
	<u>\$ 6,328,137,142</u>	<u>100.0%</u>	<u>\$ 5,436,816,445</u>	<u>100.0%</u>

¹Maturities of one year or longer, including convertible bonds.

²Interests in limited partnerships and other entities which have limited liquidity.

³Cash Equivalents includes other assets, less liabilities.

ANALYSIS OF INVESTMENT PERFORMANCE

	1997	1996	1995	1994	1993
Total Return* - Past 3 years		16.5%			
Total Return* - Past 5 years			13.0%		
Total Return* - year by year	18.8%	16.6%	14.0%	4.0%	12.1%
Actuarial Assumed Rate of Return			8.0%		
Average Net Income Yield*	3.9%	4.0%	4.7%	4.5%	4.7%
Comparative rates of return on fixed income securities					
Total fixed income - ISBI	9.5%	6.6%	11.9%	1.6%	15.6%
Comparison index:					
Shearson Lehman Aggregate	8.2%	5.0%	12.6%	(1.3%)	11.8%
Comparative rates of return on equities					
Domestic equities - ISBI	26.3%	25.9%	21.5%	5.5%	13.7%
Comparison index:					
S&P 500	34.6%	26.1%	26.1%	1.3%	13.6%

*Total return is the combined effect of income earned and market appreciation (depreciation). Average net income yield is the income earned for the year divided by the average market value of assets employed.

Investment Section

The following table shows a comparison of ISBI investment operations for fiscal years 1997 and 1996:

	1997	1996	Increase/(Decrease)	
			Amount	Percentage
Balance at beginning of year,				
at fair value	\$ 5,115,275,081	\$ 4,501,377,263	\$ 613,897,818	13.6%
Cash transferred from ISBI (net)	(99,000,000)	(120,000,000)	21,000,000	(17.5)%
Net ISBI investments revenue:				
ISBI Commingled Fund income	\$ 227,088,453	\$ 208,075,848	\$ 19,012,605	9.1%
Less ISBI Expenses	(13,418,106)	(14,584,326)	1,166,220	(8.0)%
Net ISBI investments income	\$ 213,670,347	\$ 193,491,522	\$ 20,178,825	10.4%
Net appreciation in fair value				
of ISBI investments	735,593,840	540,406,296	195,187,544	36.1%
Net ISBI investments revenue	\$ 949,264,187	\$ 733,897,818	\$ 215,366,369	29.3%
Balance at end of year, at fair value	\$ 5,965,539,268	\$ 5,115,275,081	\$ 850,264,187	16.6%

In addition, interest on the average balance in the System's cash account in the State Treasury for FY 1997 was \$3,346,821 compared to \$2,265,444 during FY 1996, primarily due to significantly higher average balances maintained during FY 1997.

STATISTICAL SECTION

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ASSET BALANCES

FY Ended June 30	Cash	Receivables	Investments*	Fixed Assets, Net of Accumulated Depreciation	Total
1988	\$ 9,893,839	\$ 6,931,093	\$ 2,367,063,722	\$ 823,484	\$ 2,384,712,138
1989	9,730,385	7,047,705	2,565,152,803	1,103,973	2,583,034,866
1990	11,187,478	8,072,524	2,775,885,256	4,340,351	2,799,485,609
1991	18,682,979	12,050,151	2,949,573,783	4,436,451	2,984,743,364
1992	12,413,156	8,546,535	3,257,144,759	4,311,268	3,282,415,718
1993	13,750,680	7,755,870	3,477,072,371	4,834,164	3,503,413,085
1994	9,590,906	9,125,040	3,703,548,563	4,485,387	3,726,749,896
1995	19,796,262	9,669,056	3,894,060,006	4,099,793	3,927,625,117
1996	51,602,122	13,215,401	5,115,275,081	3,811,862	5,183,904,466
1997	69,478,145	14,423,277	5,965,539,268	3,771,484	6,053,212,174

* Investments are reported at fair value for fiscal years 1997 and 1996. For all other fiscal years investments are reported at cost (book value).

LIABILITIES AND RESERVE BALANCES

FY Ended June 30	Accounts Payable	RESERVES				Total
		Reserve For Member Contributions	Reserve For Interest Accumulations	Reserve For Future Operations*	Total Reserves	
1988	\$ 2,906,072	\$ 699,189,621	\$ 293,701,690	\$ 1,388,914,755	\$ 2,381,806,066	\$ 2,384,712,138
1989	2,836,020	757,180,186	334,758,898	1,488,259,762	2,580,198,846	2,583,034,866
1990	3,918,499	823,025,513	380,950,235	1,591,591,362	2,795,567,110	2,799,485,609
1991	3,328,811	897,689,637	432,192,642	1,651,532,274	2,981,414,553	2,984,743,364
1992	4,168,161	867,002,526	417,372,947	1,993,872,084	3,278,247,557	3,282,415,718
1993	6,926,685	939,206,550	473,504,132	2,083,775,718	3,496,486,400	3,503,413,085
1994	4,858,736	1,029,390,486	544,137,677	2,148,362,997	3,721,891,160	3,726,749,896
1995	4,528,552	1,120,553,065	620,397,583	2,182,145,917	3,923,096,565	3,927,625,117
1996	5,224,109	1,212,036,712	701,647,209	3,264,996,436	5,178,680,357	5,183,904,466
1997	5,184,949	1,311,265,106	793,131,686	3,943,630,433	6,048,027,225	6,053,212,174

* The Reserve for Future Operations reflects investments reported at fair value for fiscal years 1997 and 1996. For all other fiscal years, the Reserve for Future Operations reflects investments reported at cost (book value).

REVENUES BY SOURCE

FY Ended June 30	Member Contributions	State Contributions	Investment Income*	Total
1988	\$ 95,928,239	\$ 99,990,922	\$ 148,802,057	\$ 344,721,218
1989	101,805,417	98,471,993	199,452,398	399,729,808
1990	110,109,685	107,938,094	213,139,724	431,187,503
1991	120,263,354	115,979,568	180,520,373	416,763,295
1992	141,862,797	98,532,783	344,237,850	584,633,430
1993	120,041,823	114,413,597	310,470,496	544,925,916
1994	128,481,556	127,649,961	312,095,169	568,226,686
1995	131,657,816	136,589,471	290,780,045	559,027,332
1996	137,220,037	146,397,934	736,163,262	1,019,781,233
1997	145,683,543	158,179,514	952,611,008	1,256,474,065

* The Investment Income includes both realized and unrealized gains and losses on investments for fiscal years 1997 and 1996. For all other fiscal years, the Investment Income includes only realized gains and losses on investments.

EXPENSES BY TYPE - SYSTEM TRUST FUND

FY Ended June 30	Benefits	Contribution Refunds (Incl. Transfers)	Administrative Expenses	Total
1988	\$ 173,644,549	\$ 11,983,814	\$ 3,169,935	\$ 188,798,298
1989	185,354,303	12,602,555	3,380,170	201,337,028
1990	199,606,912	12,325,179	3,887,148	215,819,239
1991	215,290,386	11,851,930	3,773,536	230,915,852
1992	266,652,372	16,918,761	4,229,293	287,800,426
1993	309,936,732	12,009,124	4,741,217	326,687,073
1994	326,330,535	11,411,111	5,080,280	342,821,926
1995	338,862,417	13,430,507	5,529,003	357,821,927
1996	352,478,133	13,382,158	5,654,407	371,514,698
1997	368,668,943	12,722,427	5,735,827	387,127,197

BENEFIT EXPENSES BY TYPE

FY Ended June 30	Retirement Annuities	Survivors' Annuities	Disability Benefits	Lump Sum Death Benefits	Total
1988	\$ 132,265,411	\$ 20,319,659	\$ 14,660,199	\$ 6,399,280	\$ 173,644,549
1989	142,706,550	20,987,489	14,379,147	7,281,117	185,354,303
1990	154,368,901	22,014,615	15,313,434	7,909,962	199,606,912
1991	166,360,086	23,592,609	16,655,172	8,682,519	215,290,386
1992	215,470,012	25,104,054	17,764,029	8,314,277	266,652,372
1993	256,666,173	26,958,900	17,893,919	8,417,740	309,936,732
1994	268,772,969	28,934,211	19,708,185	8,915,170	326,330,535
1995	276,614,073	31,066,250	21,368,962	9,813,132	338,862,417
1996	286,277,462	32,972,599	22,435,912	10,792,160	352,478,133
1997	298,359,093	35,239,862	23,813,616	11,256,372	368,668,943

TOTAL MEMBERSHIP - COORDINATED/NONCOORDINATED

FY Ended June 30	COORDINATED MEMBERS			NONCOORDINATED MEMBERS			Total Male Members	Total Female Members	Total Members
	Male	Female	Total	Male	Female	Total			
1988	43,988	41,914	85,902	6,257	4,342	10,599	50,245	46,256	96,501
1989	44,449	43,086	87,535	5,947	4,027	9,974	50,396	47,113	97,509
1990	45,885	44,683	90,568	5,750	3,741	9,491	51,635	48,424	100,059
1991	47,223	45,939	93,162	5,608	3,499	9,107	52,831	49,438	102,269
1992	46,536	45,131	91,667	4,316	2,639	6,955	50,852	47,770	98,622
1993	47,471	45,577	93,048	3,983	2,528	6,511	51,454	48,105	99,559
1994	48,175	45,969	94,144	3,952	2,425	6,377	52,127	48,394	100,521
1995	48,499	46,588	95,087	3,877	2,270	6,147	52,376	48,858	101,234
1996	47,070	45,481	92,551	3,801	2,156	5,957	50,871	47,637	98,508
1997	46,897	45,642	92,539	3,819	2,060	5,879	50,716	47,702	98,418

ACTIVE MEMBERSHIP - COORDINATED/NONCOORDINATED

FY Ended June 30	COORDINATED MEMBERS			NONCOORDINATED MEMBERS			Total Male Members	Total Female Members	Total Active Members	Annual Earnings Reported
	Male	Female	Total	Male	Female	Total				
1988	32,567	32,570	65,137	5,804	3,982	9,786	38,371	36,552	74,923	\$1,953,960,000
1989	33,342	34,047	67,389	5,557	3,705	9,262	38,899	37,752	76,651	2,106,121,000
1990	34,818	35,476	70,294	5,433	3,484	8,917	40,251	38,960	79,211	2,270,303,000
1991	35,984	36,461	72,445	5,325	3,253	8,578	41,309	39,714	81,023	2,461,352,000
1992	35,263	35,447	70,710	4,069	2,415	6,484	39,332	37,862	77,194	2,439,708,000
1993	35,782	35,324	71,106	3,734	2,306	6,040	39,516	37,630	77,146	2,450,350,000
1994	36,650	35,867	72,517	3,719	2,204	5,923	40,369	38,071	78,440	2,623,793,000
1995	36,777	36,306	73,083	3,644	2,069	5,713	40,421	38,375	78,796	2,756,072,000
1996	37,053	36,597	73,650	3,584	1,978	5,562	40,637	38,575	79,212	2,871,501,000
1997	37,279	36,909	74,188	3,617	1,892	5,509	40,896	38,801	79,697	3,003,628,000

NUMBER OF RECURRING BENEFIT PAYMENTS - SYSTEM TRUST FUND

FY Ended June 30	Retirement Annuities	Survivors' Annuities	Disability* Benefits	Total
1988	23,038	8,296	1,536	32,870
1989	23,572	8,499	1,458	33,529
1990	23,864	8,629	1,501	33,994
1991	24,283	8,819	1,583	34,685
1992	28,501	8,951	1,559	39,011
1993	28,308	9,115	1,643	39,066
1994	28,129	9,245	1,708	39,082
1995	27,902	9,401	1,801	39,104
1996	27,900	9,462	1,870	39,232
1997	27,690	9,565	1,976	39,231

*Includes individuals receiving total temporary disability payments under the Workers' Compensation Act.

TERMINATION REFUNDS - NUMBER/AMOUNT

1988	4,431	\$ 11,015,216
1989	3,879	11,393,289
1990	3,509	11,088,659
1991	3,235	10,488,713
1992	3,257	11,634,268
1993	2,797	10,737,417
1994	2,961	10,303,901
1995	3,025	11,782,320
1996	2,930	11,943,623
1997	2,244	11,349,768

RETIREMENT ANNUITIES**Average Monthly Benefit For Current Year Retirees By Type**

Fiscal Year Ending June 30	1997	1996	1995	1994	1993
Not Coordinated with Social Security	\$ 1,586.25	\$ 1,303.20	\$ 1,148.34	\$ 918.46	\$ 1,057.75
Coordinated with Social Security	547.38	556.97	503.63	452.06	418.51
Alternative Formula	3,945.25	3,491.74	3,407.17	3,716.55	3,425.19
Dept. of Corrections - Special Formula - Not Coordinated with Social Security	2,363.71	2,145.22	2,157.93	2,255.04	2,111.92
Dept. of Corrections - Special Formula Coordinated with Social Security	1,608.99	1,414.94	1,217.66	1,109.41	945.65
Air Pilots - Coordinated with Social Security	-	-	-	-	2,082.77
Court Reporters - Not Coordinated with Social Security	1,851.45	854.78	2,242.57	2,069.37	-
Court Reporters - Coordinated with Social Security	1,490.00	1,362.34	1,120.06	1,436.76	399.37
Total Average	<u>\$ 1,036.51</u>	<u>\$ 855.84</u>	<u>\$ 757.57</u>	<u>\$ 723.53</u>	<u>\$ 1,302.27</u>

RETIREMENT ANNUITIES**Current Age of Active Recipients**

Age	1997	1996	1995	1994	1993
Under 51	56	91	114	164	223
51-55	445	484	589	671	768
56-60	1,368	1,531	1,641	1,714	1,880
61-65	3,845	3,939	3,971	4,084	4,184
66-70	5,807	5,953	5,995	6,219	6,375
71-75	5,981	6,018	6,023	5,879	5,755
76-80	4,708	4,657	4,656	4,653	4,589
81-85	3,349	3,241	3,071	2,982	2,871
86-89	1,380	1,250	1,163	1,102	1,038
Over 89	751	736	679	661	625
Total	<u>27,690</u>	<u>27,900</u>	<u>27,902</u>	<u>28,129</u>	<u>28,308</u>
Average age	<u>72.77</u>	<u>72.45</u>	<u>72.14</u>	<u>71.84</u>	<u>71.44</u>

RETIREMENT ANNUITIES**Average Service (in months) for Current Year Retirees at Effective Date of Benefit**

Fiscal Year Ending June 30	1997	1996	1995	1994	1993
Not Coordinated with Social Security	378.95	372.90	370.36	370.34	350.78
Coordinated with Social Security	228.55	232.28	224.53	223.30	216.06
Alternative Formula	347.12	343.09	354.23	361.57	350.02
Dept. of Corrections - Special Formula - Not Coordinated with Social Security	371.85	350.03	371.57	348.62	354.05
Dept. of Corrections - Special Formula - Coordinated with Social Security	299.08	287.70	289.54	288.32	277.78
Air Pilots - Coordinated with Social Security	-	-	-	-	-
Court Reporters - Not Coordinated with Social Security	369.33	204.00	360.00	409.81	-
Court Reporters - Coordinated with Social Security	314.20	316.00	277.00	333.50	177.75
Total Average	<u>273.12</u>	<u>266.23</u>	<u>265.25</u>	<u>268.36</u>	<u>279.31</u>

Annuitants by Benefit Range (Monthly) June 30, 1997

Benefit Range	Total	Cumulative Total	% of Total	Cumulative % of Total
\$ 1-100	584	584	2.1	2.1
101-200	2,773	3,357	10.0	12.1
201-300	3,640	6,997	13.1	25.2
301-400	3,065	10,062	11.1	36.3
401-500	2,514	12,576	9.1	45.4
501-600	1,988	14,564	7.2	52.6
601-700	1,657	16,221	6.0	58.6
701-800	1,354	17,575	4.9	63.5
801-900	996	18,571	3.6	67.1
901-1000	827	19,398	3.0	70.1
1001-1100	733	20,131	2.6	72.7
1101-1200	690	20,821	2.5	75.2
1201-1300	644	21,465	2.3	77.5
1301-1400	545	22,010	2.0	79.5
1401-1500	473	22,483	1.7	81.2
1501-1600	432	22,915	1.6	82.8
1601-1700	375	23,290	1.4	84.2
1701-1800	378	23,668	1.4	85.6
1801-1900	324	23,992	1.2	86.8
1901-2000	304	24,296	1.1	87.9
2001-2100	274	24,570	0.9	88.8
2101-2200	270	24,840	0.9	89.7
2201-5000	2,833	27,673	10.2	99.9
5000- & over	17	27,690	0.1	100.0

Widow's and Survivors' by Benefit Range (Monthly) June 30, 1997

Benefit Range	Total	Cumulative Total	% of Total	Cumulative % of Total
\$ 1-100	1,987	1,987	20.8	20.8
101-200	1,982	3,969	20.7	41.5
201-300	1,857	5,826	19.4	60.9
301-400	1,448	7,274	15.1	76.0
401-500	876	8,150	9.2	85.2
501-600	467	8,617	4.9	90.1
601-700	232	8,849	2.4	92.5
701-800	167	9,016	1.7	94.2
801-900	141	9,157	1.5	95.7
901-1000	115	9,272	1.2	96.9
1001-1100	71	9,343	0.7	97.6
1101-1200	63	9,406	0.7	98.3
1201-1300	30	9,436	0.3	98.6
1301-1400	25	9,461	0.3	98.9
1401-1500	25	9,486	0.3	99.2
1501-1600	18	9,504	0.2	99.4
1601-1700	18	9,522	0.2	99.6
1701-1800	15	9,537	0.2	99.8
1801-1900	11	9,548	0.1	99.9
1901-2000	7	9,555	0.1	100.0
2001-2100	4	9,559	0.0	100.0
2101-2200	3	9,562	0.0	100.0
2201-5000	3	9,565	0.0	100.0
5000- & over	0	9,565	0.0	100.0

Occupational and Non-Occupational (Incl. Temp) Disabilities by Benefit Range (Monthly) June 30, 1997

Benefit Range	Total	Cumulative Total	% of Total	Cumulative % of Total
\$ 1-100	27	27	1.4	1.4
101-200	80	107	4.0	5.4
201-300	182	289	9.2	14.6
301-400	223	512	11.3	25.9
401-500	224	736	11.3	37.2
501-600	148	884	7.5	44.7
601-700	102	986	5.2	49.9
701-800	76	1,062	3.8	53.7
801-900	70	1,132	3.5	57.2
901-1000	94	1,226	4.8	62.0
1001-1100	118	1,344	6.0	68.0
1101-1200	89	1,433	4.5	72.5
1201-1300	86	1,519	4.4	76.9
1301-1400	85	1,604	4.3	81.2
1401-1500	75	1,679	3.8	85.0
1501-1600	68	1,747	3.4	88.4
1601-1700	78	1,825	3.9	92.3
1701-1800	39	1,864	2.0	94.3
1801-1900	20	1,884	1.0	95.3
1901-2000	22	1,906	1.1	96.4
2001-2100	23	1,929	1.2	97.6
2101-2200	12	1,941	0.6	98.2
2201-5000	35	1,976	1.8	100.0
5000- & over	0	1,976	0.0	100.0

Active Retirees by State



PLAN SUMMARY AND LEGISLATION SECTION

- Plan Summary
- Legislation

SUMMARY OF RETIREMENT SYSTEM PLAN

(As of June 30, 1997)

1. PURPOSE

The State Employees' Retirement System of Illinois, a state agency, provides an orderly means whereby aged or disabled employees may be retired from active service without prejudice or hardship and enables the employees to accumulate reserves for themselves and their dependents for old age, disability, death and termination of employment.

2. ADMINISTRATION

Responsibility for the operation of the System and the direction of its policies is vested in a Board of Trustees consisting of seven members. The administration of the System is the responsibility of the Executive Secretary who is appointed by the Board of Trustees. Administrative policies and procedures are designed to ensure an accurate accounting of funds of the System and prompt payment of claims for benefits within the applicable statute.

3. EMPLOYEE MEMBERSHIP

Generally all persons entering state service become members of the System after serving a six-month qualifying period unless their position is subject to membership in another state supported system. Any enrollee of the Young Adult Conservation Corps is excluded from membership. Employees appointed by the Governor and requiring confirmation by the State of Illinois Senate may elect to become members of the System. Several other exceptions may also apply.

4. MEMBER CONTRIBUTIONS

Members are required to contribute a percentage of salary as their share of meeting the cost of the various benefits. Contribution rates are as shown below:

- A. Members Coordinated with Social Security - 4% of salary
- B. Members Without Social Security - 8% of salary
- C. State Police, Special Agents, Firefighters, Secretary of State Investigators, Conservation Police Officers, Department of Revenue Investigators, Central Management Services Security Police, Mental Health Police Officers, Dangerous Drug Investigators for Department of Alcoholism and Substance Abuse, Attorney General Investigators, State's Attorneys Appellate Prosecutor Investigators, and Commerce Commission Police Officers - 9 1/2% of salary
- D. Full Time Security Employees of the Department of Corrections; Air Pilots -
 - (1) Coordinated with Social Security - 5 1/2% of salary
 - (2) Without Social Security - 9 1/2% of salary

Members coordinated with social security also pay the current social security tax rate.

Effective January 1, 1992, most state agencies began participation in an employer pickup of employee retirement contributions program in lieu of a pay increase. The employer (i.e. the State of Illinois) now pays all or a part of the required employee contributions on behalf of its employees.

5. RETIREMENT ANNUITY

A. Qualification of Member

Upon termination of state service, a member is eligible for a retirement annuity at age 60 with at least eight years of service credit; at any age with 35 or more years of credit; between ages 55 and 60 with 30 to 35 years of credit with the retirement annuity reduced by one-half of 1% for each month the member is under age 60. Security employees of the Department of Corrections and the Department of Mental Health and Developmental Disabilities - Chester, Illinois who are not eligible for the Alternative Formula must have at least 20 years of membership service to qualify for special retirement formulas which will apply only to the service earned while in a security position.

Members in Alternative Formula positions are eligible at age 50 with at least 25 years of eligible creditable service or at age 55 with at least 20 years of eligible creditable service in such a position.

B. Amount of Retirement Annuity

The retirement annuity is based on the member's final average compensation and the number of years of service credit that have been established. The retirement formula reflects a graded or progressive method according to length of service as follows:

Years of Credit	Employees Under Social Security	Employees Not Under Social Security	Full Time Security Employees- Dept. of Corrections*		Alternative Formula, i.e. Police and other positions		Court Reporter	
			Under S.S./Not Under S.S.	Under S.S./Not Under S.S.	Under S.S./Not Under S.S.	Under S.S./Not Under S.S.	Under S.S./Not Under S.S.	Under S.S./Not Under S.S.
Each of the first 10 years of credit	1.0%	1.67%	1.67%	1.90%	1.67%	2.25%	1.5%	2.2%
Each of the second 10 years of credit	1.1%	1.90%	1.90%	2.10%	1.90%	2.50%	1.5%	2.2%
Each of the third 10 years of credit	1.3%	2.10%	2.10%	2.25%	2.10%	2.75%	1.5%	2.2%
Each year above 30 years	1.5%	2.30%	2.30%	2.50%	2.30%	2.75%	1.5%	2.2%

*Who are not eligible for the Alternative Formula. Also included in this group are Department of Mental Health - Chester, Illinois security employees.

The maximum retirement annuity payable is 75% of final average compensation. The minimum retirement annuity payable is \$7.50 for each year of covered employment and \$15.00 for each year of noncovered employment.

C. Optional Forms of Payment

Reversionary Annuity - A member may elect to receive a smaller retirement annuity during his lifetime in order to provide a designated dependent with a lifetime income. That payment would be in addition to any other benefit payable by the System.

Level Income - A member who contributes to social security as a state employee may elect to have his retirement annuity payments increased before the age at which the member can receive social security benefits and reduced after that age to provide a uniform retirement annuity income throughout his retired life. To be eligible for this election the member must have established eligibility for a social security retirement annuity.

D. Annual Increase in Benefit

Post retirement increases of 3% are granted to members effective each January 1, after receipt of benefits for one full year.

6. SURVIVORS' ANNUITY

A. Qualification of Survivor

If death occurs while in state employment, the member must have established at least 18 months of service credit. If death occurs after termination of state service and the member was not receiving a retirement annuity, the member must have established at least eight years of service credit.

An eligible spouse qualifies at age 50 or at any age if there is in the care of the spouse any unmarried children of the member under age 18 or over 18 if mentally or physically disabled and unable to work; unmarried children under age 18 if no spouse survives; or dependent parents at age 50 if neither an eligible spouse nor eligible children survive the member.

A spouse that is the sole nominated beneficiary and sole survivor may elect other death benefits as described in Number 9.

B. Amount of Payment

If the member's death occurs before retirement, the named beneficiary receives a lump sum refund of all the member's retirement contributions plus the interest credited to the member's account, excluding contributions for widow and survivors' benefits. A single lump sum payment of \$1,000 is also made to the qualified survivor of the member.

An eligible spouse receives a monthly annuity equal to 30% of the member's final average compensation subject to a maximum of \$400. If children of the member are under the care of the spouse, the annuity is increased for each child, subject to a maximum of \$600 or 80% of final average compensation. If only eligible children survive, the monthly annuity may not exceed the lesser of \$600 or 80% of final average compensation. The maximum combined monthly payment to parents may not exceed \$400. If the member's death occurs after retirement or after termination of state employment, but before the member receives a retirement annuity, the monthly benefit is the same as during active employment or 80% of the earned retirement annuity at date of death.

The minimum total survivor benefit payable to the survivors' annuity beneficiaries of a deceased member or annuitant shall be 50% of the amount of retirement annuity that was or would have been payable to the deceased member on the date of death. Monthly benefits payable to survivors of a member who was covered by social security as a state employee are reduced by one-half of the amount of benefits they are eligible to receive from social security as a widow(er). The social security offset may not reduce the benefit by more than 50%.

C. Duration of Payment

The monthly annuity payable to a spouse terminates upon death or remarriage prior to attainment of age 55; to children upon death, marriage, or attainment of age 18, except for a child who at age 18 is physically or mentally disabled and unable to accept gainful employment, which terminate at death or gainful employment. Dependent parents' benefits terminate at death or remarriage.

D. Annual Increase in Benefit

The survivor benefit is increased by 3% each January 1, after receipt of benefits for one full year. Survivors of retired members receive an increase on January 1 following the commencement of the benefit.

7. WIDOW'S ANNUITY

The widow of a male member who was a participant in the System prior to July 19, 1961, may have the option of taking a Widow's Annuity rather than the Survivors' Annuity.

A. Qualification of Widow

An eligible widow receives a Widow's Annuity if she is age 50 or over or has in her care any of the member's unmarried children under age 18. If she is not age 50 and has no such children in her care, she becomes eligible at age 50.

B. Amount of Payment

The Widow's Annuity consists of a lump sum payment of \$500, plus a monthly annuity equal to 50% of the retirement annuity earned or received by the member at the date of death. If the widow has in her care eligible children of the member, the monthly annuity is increased 5% because of each child, subject to a maximum payment equal to $66\frac{2}{3}\%$ of the earned retirement annuity. Monthly benefits payable to a widow of a member who was covered by social security as a state employee are reduced by one-half of the amount of benefits she is eligible to receive from social security as a widow. The social security offset may not reduce the benefit by more than 50%.

C. Duration of Payment

The monthly payment to the widow continues for her lifetime whether or not she remarries. If the amount of benefit was increased because of eligible children, it is adjusted downward as these children's benefits are terminated (death, marriage or attainment of age 18).

D. Annual Increase in Benefit

The widow's benefit is increased by 3% each January 1, after receipt of benefits for one full year. Widows of retired members receive the increase on January 1 following the commencement of the benefit.

8. OCCUPATIONAL DEATH BENEFIT

A. Qualification of Survivors

If a member's death results from a job related cause, the spouse may be eligible for an Occupational Death benefit. If only unmarried children under age 18 survive, they may be eligible for the benefit. If neither spouse nor eligible children survive, a dependent father or mother may be eligible.

B. Amount of Payment

The nominated beneficiary receives a lump sum payment consisting of all contributions made by the member plus the interest credited to the member's account. A surviving spouse is entitled to a monthly benefit equal to 50% of the member's final average compensation. If children under age 18 also survive, the annuity is increased by 15% of such average because of each child subject to a maximum of 75%. If there is no eligible spouse and children under age 18 survive, each child receives a monthly allowance of 15% of the final average compensation. The combined payment to children may not exceed 50% of the member's final average compensation. If there is no eligible spouse or eligible children, a benefit of 25% of final average compensation is payable to each surviving dependent parent for life. The monthly benefit is reduced by any payments awarded under the Workers' Compensation Act or Workers' Occupational Diseases Act.

C. Duration of Payment

The monthly annuity payable to a spouse terminates at death, or remarriage before age 55; to children at death, or attainment of age 18, or marriage.

D. Annual Increase in Benefit

The Occupational Death Benefit is increased by 3% each January 1 after receipt of benefits for one full year.

9. OTHER DEATH BENEFITS

If the beneficiary(ies) of the member do not qualify for any of the previously described death benefits, one of the following benefits is payable.

A. Before Retirement

If a member's death occurred while in state service, the benefit consists of: (1) a refund of all contributions plus the interest credited to the member's account; and (2) a payment equal to one month's salary for each full year of service credit not to exceed six month's salary.

If the member had terminated state service, but not yet qualified for a retirement annuity, the benefit consists of a refund of all of the member's contributions to the System plus the interest credited to the member's account.

B. After Retirement

The benefit consists of a lump sum payment equal to the excess of contributions plus the interest credited to the member's account over the total amount of retirement annuity payments made to the member. The minimum payment is \$500.

10. NONOCCUPATIONAL DISABILITY BENEFITS

A. Qualification and Amount of Payment

Available to any member who has established at least 18 months of creditable service and who has been granted a disability leave of absence by the employing agency. The benefit is 50% of final average

compensation and credit to the member's account of service and contributions. It begins on the 31st day of absence from service on account of disability (including any periods for which sick pay was received).

If the member has social security coverage as a state employee, the benefit payable by the System is reduced by the amount of any disability or retirement payment to which he is entitled under social security.

B. Duration of Payment

The member is eligible for the monthly benefit until the occurrence of any of the following events: (1) disability ceases; (2) resumption of gainful employment; (3) payments are made for a period of time equal to one-half of the service credit established as of the date disability began; (4) attainment of age 65, if benefit commenced prior to the attainment of age 60; (5) the fifth anniversary of the effective date of the benefit if the benefit commenced on or after the attainment of age 60; or (6) death of the member.

C. Increase in Benefit

The Nonoccupational Disability benefit shall be increased by 7% following the fourth anniversary of the benefit and 3% each year thereafter.

11. OCCUPATIONAL DISABILITY BENEFIT

A. Qualification and Amount of Payment

Provided for any member who becomes disabled as the direct result of injury or disease arising out of and in the course of state employment.

The benefit is 75% of final average compensation plus a credit to the member's account of service and contributions. The cash benefit is reduced by any payment received under the Workers' Compensation Act or Workers' Occupational Diseases Act.

B. Duration of Payment

Monthly benefits are payable until the occurrence of any of the following events: (1) disability ceases; (2) resumption of gainful employment; or (3) attainment of age 65, if benefit commenced prior to the attainment of age 60; (4) the fifth anniversary of the effective date of the benefit if the benefit commenced on or after the attainment of age 60; or (5) death of the member.

C. Increase in Benefit

The Occupational Disability benefit shall be increased by 7% following the fourth anniversary of the benefit and 3% each year thereafter.

12. TEMPORARY DISABILITY BENEFIT

A. Qualification and Amount of Benefit

Available to any member who becomes disabled, has established at least 18 months of creditable service, has been denied benefits under the Workers' Compensation Act or the Workers' Occupational Diseases Act, or had benefits terminated, and has filed an appeal with the Industrial Commission of Illinois. The benefit is 50% of final average compensation plus credit to the member's account of service and contributions. The benefit shall begin to accrue on the 31st day of absence from service and shall be payable upon the expiration of 150 days from the day the member last received compensation.

If the member has social security coverage as a state employee, the benefit payable by the System is reduced by the amount of any disability or retirement payment to which he is eligible under social security.

B. Duration of Payment

The member is eligible for the monthly benefit until the occurrence of any of the following events: (1) disability ceases; (2) resumption of gainful employment; (3) payments are made for a period of time equal to

one-half of the service credit established as of the date disability began; or (4) attainment of age 65, if the benefit commenced prior to the attainment of age 60; or (5) the fifth anniversary of the effective date of the benefit if the benefit commenced on or after the attainment of age 60; or (6) death of the member; or (7) benefits are paid or awarded under the Workers' Compensation Act or the Workers' Occupational Diseases Act.

13. SEPARATION BENEFITS

Upon termination of state employment by resignation, discharge, dismissal or layoff, a member may obtain a refund of the contributions made to the System. The member must be off the payroll for 14 days to be eligible for a refund. By accepting a refund, a member forfeits all accrued rights and benefits in the System for himself and his beneficiaries.

LEGISLATION

LEGISLATIVE AMENDMENTS - Amendments with an effective date during Fiscal Year 1997:

House Bill 2616 (P.A. 89-0616; Effective August 9, 1996)

Increases the minimum retirement annuity for retirees of SERS. For retired coordinated members, the current minimum of \$7.50 per month per year of service (maximum of 30 years) would increase to \$15 per year of service. For retired noncoordinated members, the current minimum of \$15 per month of service (maximum of 30 years) would increase to \$25 per year of service.

Senate Bill 1456 (P.A. 89-0643; Effective August 9, 1996)

Allows any chief of the County Police Department or undersheriff of the County Sheriff's Department who elects to be included within the provisions of Section 9-128.1 of Article 9 of the Illinois Pension Code to transfer creditable service to the County Employees' and Officers' Annuity and Benefit Fund (Article 9 the Illinois Pension Code).

House Bill 366 (P.A. 90-0019; Effective June 20, 1997)

- * Allows each retirement system established under the Illinois Pension Code to define their limitation year regarding benefit limits set by Section 415 of the U.S. Internal Revenue Code.
- * Requires the Illinois State Board of Investment (ISBI) to report the value of their investments in accordance with generally accepted accounting principles (GAAP) rather than at cost. SERS will include the ISBI reported amounts under GAAP in its financial statements.

House Bill 313 (P.A. 90-0032; Effective June 27, 1997)

- * Allows SERS members to purchase service credit for leaves of absence of less than one year which began on or after January 1, 1982. Requires an employee/employer contribution, plus interest.
- * Allows an active employee to purchase service credit for full-time employment with the federal government, or unit of state or local government outside of Illinois. Limits the amount of service purchased to eight years or 40% of membership service, whichever is less. Federal service does not include military service. This option is available through June 30, 1998 only. Requires an employee/employer contribution, plus interest.
- * Allows arson investigators employed by the State Fire Marshal's Office who have been determined to be in police positions to participate in the Alternative retirement formula.
- * Allows controlled substance inspectors to transfer up to 10 years of police or sheriff officer service established in a downstate police fund or IMRF. Requires an employee/employer contribution, plus interest.
- * Allows employees covered under the Alternative formula who worked for the federal, a state, or local government outside of Illinois, to establish service credit for full-time law enforcement or corrections officer. Limits the service credit to 12 years. This option is available through March 31, 1998 only. Requires an employee/employer contribution, plus interest.
- * Allows security employees with the Department of Corrections to establish up to ten years of service as a policeman under Article 3 of the Pension Code. This option is available through July 1, 1998 only. Requires an employee/employer contribution, plus interest.

NEW LEGISLATION - Amendments with an effective date subsequent to June 30, 1997, affecting the operation of the System:

House Bill 110 (P.A. 90-0065; Effective July 15, 1997)

This law change affects anyone retiring on or after January 1, 1998. The legislation switches employees covered by Social Security (coordinated) from a step rate benefit formula ranging from 1.0% to 1.5% per year of service to a flat rate formula of 1.67% for all years of service.

Employees without Social Security (non-coordinated) will move from a step rate ranging from 1.67% to 2.3% to a flat rate formula of 2.2% for all years of service.

The legislation also includes the following items:

- * Generally, most state employees, except alternative formula employees, will forgo a three percent cost-of-living increase this fiscal year, but will receive a onetime stipend;
- * Members will no longer receive pay for one-half of their unused sick leave earned on and after January 1, 1998;
- * Some future retirees will have to pay a percentage of their health insurance benefits.

The pension package is linked to a three-year labor contract that will give employees a 3% cost-of-living increase in the second and third years of the contract.

The new legislation also allows all members with 20 years of Alternative formula service to retire at a monthly rate based on their final rate of pay at retirement or an average of the last 48 months of service, whichever is greater.

The pension increase to a flat rate of 1.67/2.2% does not apply to members under the Alternative formula, since their retirement rates are already higher. Workers covered by the Alternative formula will receive a 3% cost-of-living increase all three years of the new contract. The legislation also establishes minimum state contribution rates between FY1999 and FY2010 designed to fund the increased benefits as a level percentage of payroll over the remainder of the 50 year funding program.

Senate Bill 665 (P.A. 90-0448; Effective August 16, 1997)

- * The State Withholding Act and the Retirement Act are amended to provide a method so that contributions made to purchase optional service credit or repay prior refunds can be made on a pre-tax basis through payroll deduction.
- * Allows a person who performed contractual services to a member of the General Assembly, in the member's district office to establish up to three years of service credit in SERS. The legislation requires an employee contribution, plus interest. Application must be made to SERS by March 1, 1998.
- * The SERS Widow, Survivors, and Occupational Death benefits are altered to allow payment of the benefit to a child under the age of 22, who is a full-time student. Presently, this benefit is terminated at age 18, regardless of student status.

House Bill 1641 (P.A. 90-0511; Effective August 22, 1997)

- * Allows someone who performed contractual services for a member of the General Assembly, in the member's district office, to purchase up to eight years of service credit in SERS. The legislation requires an employee contribution, plus interest. Application must be made to SERS by March 1, 1998.

